Supreme Court, U.S.
FILED

94 632 OCT - 6 1994

OFFICE OF THE CLERK

No. _____

In The

# Supreme Court of the United States

October Term, 1994

MAURICE SPORTING GOODS, INC.,

*Petitioner,*

v.

MAXWAY CORPORATION and DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,

*Respondents.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit**

## PETITION FOR WRIT OF CERTIORARI

JOHN HENDERSON HASTY
Counsel of Record

KIRBY TODD PHILLIPS
WAGGONER, HAMRICK, HASTY, MONTEITH & KRATT
Suite 2500
Two First Union Center
Charlotte, North Carolina 28282
Telephone: (704) 332-6141
Telecopier: (704) 375-5102

*Attorneys for Petitioner*

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

10

## QUESTION PRESENTED

11 U.S.C. §546(a) provides that preference actions under §547 of the Bankruptcy Code must be brought within two years of the appointment of a trustee under the Bankruptcy Code; 11 U.S.C. §1107(a) provides that a Chapter 11 debtor-in-possession is "[s]ubject to any limitations on a trustee serving in a case under this chapter". The issue presented is whether a debtor-in-possession, acting as a trustee under §1107(a), is subject to the two-year statute of limitations imposed by §546(a)(1), or, irrespective of the plain language of §1107(a), that a debtor-in-possession is free to bring preference actions at any time until the case is closed or dismissed, which may be five, ten, twenty, or even more years after the commencement of the bankruptcy case.

## LIST OF PARTIES

The parties to the proceedings below were the Petitioner, Maurice Sporting Goods, Inc., and the Respondents, Maxway Corporation and Danners, Inc., acting by and through their Official Committee of Unsecured Creditors.

Maurice Sporting Goods, Inc. ("Maurice") is a corporation organized under the laws of the state of Illinois. Maurice is 100% privately held. Maurice has no subsidiaries, other than one wholly-owned subsidiary.

TABLE OF CONTENTS

Page

QUESTION PRESENTED ..... i

LIST OF PARTIES ..... ii

TABLE OF AUTHORITIES ..... v

OPINIONS BELOW ..... 2

BASIS FOR THE COURT'S JURISDICTION ..... 2

STATUTES INVOLVED ..... 3

STATEMENT OF THE CASE ..... 5

REASONS FOR GRANTING THE WRIT ..... 10

I. THIS CASE PRESENTS AN IMPORTANT AND REOCCURRING QUESTION OF FEDERAL BANKRUPTCY LAW ON WHICH THE COURTS OF APPEAL ARE SQUARELY DIVIDED ..... 11

A. THIS CASE PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH AFFECTS THE ADMINISTRATION OF CHAPTER 11 BANKRUPTCY CASES .... 11

B. THE COURTS OF APPEAL ARE SQUARELY DIVIDED OVER THE ISSUE ..... 12

C. THE QUESTION PRESENTED ARISES FREQUENTLY WITH DIVIDED RESULTS ..... 15

II. THE FOURTH CIRCUIT ERRED IN ITS CONSTRUCTION OF BANKRUPTCY CODE §§ 1107(a) AND 546(a) AND SHOULD BE REVERSED ..... 16

A. THE FOURTH CIRCUIT ERRED BY IGNORING THE PLAIN LANGUAGE OF CODE §1107(a) ..... 16

TABLE OF CONTENTS – Continued

Page

B. THE FOURTH CIRCUIT ERRED BY FAILING TO ANALYZE CODE §546(a)(1) HOLISTICALLY ..... 20

C. THE FOURTH CIRCUIT ERRED BY FAILING TO RECOGNIZE AND ADDRESS CODE §546(a)'S AMBIGUITY ..... 23

1. The Language of Code §546(a) Demonstrates Its Ambiguity ..... 24

2. Code §546(a)(1)'s Language "after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202" is Ambiguous ..... 24

D. THE FOURTH CIRCUIT'S DECISION LEADS TO ABSURD RESULTS NOT INTENDED BY THE DRAFTERS ..... 27

CONCLUSION ..... 28

# TABLE OF AUTHORITIES

Page

SUPREME COURT DECISIONS

*Barnhill v. Johnson*, 503 U.S. ___, 112 S.Ct. 1386, 118 L.Ed.2d 39 (1992) ..... 14

*City of New York v. Saper*, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710 (1948) ..... 11

*Dewsnup v. Timm*, 502 U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992) ..... 15, 23, 24

*Herget v. Central National Bank & Trust Co. of Peoria*, 324 U.S. 4, 65 S.Ct. 505, 89 L.Ed. 656 (1945) ..... 23

*Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) ..... 15

*Kelly v. Robinson*, 479 U.S. 36, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) ..... 20

*King v. St. Vincent's Hospital*, 502 U.S. ___, 112 S.Ct. 570, 116 L.Ed.2d 578 (1991) ..... 20

*Massachusetts v. Marash*, 490 U.S. 107, 109 S.Ct. 1668, 104 L.Ed.2d 98 (1989) ..... 20

*Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 109 S.Ct. 588, 109 L.Ed.2d 588 (1990) ..... 15

*Segal v. Rochelle*, 382 U.S. 381, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966) ..... 15

*Union Bank v. Wolas*, 502 U.S. ___, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991) ..... 11

*United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) ..... 17, 21

*United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983) ..... 16, 17, 22

TABLE OF AUTHORITIES – Continued

Page

*United States Savings Association v. Timbers of Inwood Forest, Ltd.*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988) ..... 21

*Wolf v. Weinstein*, 372 U.S. 633, 83 S.Ct. 969, 10 L.Ed.2d 33 (1963) ..... 17, 22

COURTS OF APPEAL DECISIONS

*In re Century Brass Products, Inc.*, 22 F.3d 37 (2d Cir. 1994) ..... 9, 12, 13

*In re Coastal Group, Inc.*, 13 F.3d 81 (3d Cir. 1994) ..... 9, 12, 13

*In re Softwaire Centre International, Inc.*, 994 F.2d 682 (9th Cir. 1993) ..... 9, 12

*Matter of Hughes*, 704 F.2d 820 (5th Cir. 1983) ..... 22

*Schokbeton Industries, Inc. v. Schokbeton Products Corp.*, 466 F.2d 171 (5th Cir. 1972) ..... 17

*Zilkha Energy Company v. Leighton*, 920 F.2d 1520 (10th Cir. 1990) ..... 9, 13, 24

BANKRUPTCY COURT AND DISTRICT COURT DECISIONS

*In re Black & Geddes, Inc.*, 35 B.R. 827 (Bankr. S.D. N.Y. 1983) ..... 25

*In re Chapel Gate Apartments, Ltd.*, 64 B.R. 569 (Bankr. N.D. Tex. 1986) ..... 22

*In re Chattanooga Wholesale Antiques, Inc.*, 67 B.R. 899 (Bankr. E.D. Tenn. 1986) ..... 22

*In re Flying "S" Land & Cattle Company, Inc.*, 71 B.R. 183 (Bankr. D. Nev. 1987) ..... 22

TABLE OF AUTHORITIES – Continued

Page

*In re Harstad*, 1994 WL 421988, 1994 U.S. Dist. Lexis 11299 (expected to be reported at 170 B.R. 666) (D. Minn. 1994) ..... 15

*In re Herberman*, 122 B.R. 273 (Bankr. W.D. Tex. 1990) ..... 26

*In re Hooker Investments, Inc.*, 162 B.R. 426 (Bankr. S.D. N.Y. 1993) ..... 13

*In re Knapp*, 146 B.R. 294 (Bankr. M.D. Fla. 1992) .... 15

*In re Korvettes, Inc.*, 42 B.R. 217 (Bankr. S.D. N.Y. 1984), *rev'd on other grounds*, 67 B.R. 730 (S.D. N.Y. 1986) ..... 14

*In re Lill*, 116 B.R. 543 (Bankr. N.D. Ohio 1990) ..... 15

*In re Marker*, 100 B.R. 569 (Bankr. N.D. Ala. 1989) .... 28

*In re Mars Stores, Inc.*, 150 B.R. 869 (Bankr. D. Mass. 1993) ..... 15

*In re National Steel Service Center, Inc.*, 1994 WL 456641, 1994 Bankr. Lexis 1248 (expected to be reported at 170 B.R. 745) (Bankr. N.D. Ga. 1994) .... 15

*In re Springfield Furniture, Inc.*, 145 B.R. 520 (Bankr. E.D. Va. 1992) .....25, 27

*In re T S Industries, Inc.*, 125 B.R. 638 (Bankr. D. Utah 1991) ..... 28

*In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518 (Bankr. E.D. N.Y. 1989) .....22, 26

*Sparmal Enterprises, Inc. v. Moffit Realty Corp.*, 126 B.R. 559 (S.D. Ill. 1991) .....15, 24

TABLE OF AUTHORITIES – Continued

Page

STATUTES AND RULES

11 U.S.C. §108 ..... 23

11 U.S.C. §350 ..... 14

11 U.S.C. §546(a) ..... *passim*

11 U.S.C. §547(b) ..... 3, 4, 21

11 U.S.C. §549 ..... 22

11 U.S.C. §701 ..... 21, 25

11 U.S.C. §702 ..... 24, 25, 27

11 U.S.C. §703 ..... 25

11 U.S.C. §1101(1) ..... 4, 21, 22, 25, 26, 28

11 U.S.C. §1107(a) ..... *passim*

11 U.S.C. §1123 ..... 7

11 U.S.C. §1202 ..... 21, 24, 25, 27

11 U.S.C. §1302 ..... 21, 24, 25, 27

28 U.S.C. §586(b) ..... 25

28 U.S.C. §1254(1) ..... 3

OTHER AUTHORITIES

H.R. Rep. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977) ..... 20, 26, 27

S. Rep. 95-989 to accompany S. 2266, 95th Cong., 2d Sess. (1978) ..... 20, 26, 27

*Black's Law Dictionary* (6th ed. 1991) ..... 18, 19

No. _____

In The

# Supreme Court of the United States

October Term, 1994

MAURICE SPORTING GOODS, INC.,

*Petitioner,*

v.

MAXWAY CORPORATION and DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,

*Respondents.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit**

## PETITION FOR WRIT OF CERTIORARI

Maurice Sporting Goods, Inc., the Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-entitled proceeding on June 23, 1994.

## OPINIONS BELOW

The opinion of the Court of Appeals for the Fourth Circuit (the "Fourth Circuit") is reported at 27 F.3d 980 and reprinted in the Appendix at App.-1.

The decision of the United States District Court for the Western District of North Carolina (the "District Court") is not published and is reprinted in the Appendix at App.-13.

The order and judgment of the United States Bankruptcy Court for the Western District of North Carolina (the "Bankruptcy Court") are not published and are reprinted in the Appendix at App.-15 and App.-38, respectively.

## BASIS FOR THE COURT'S JURISDICTION

Invoking jurisdiction under 28 U.S.C. §§ 151, 157, and 1334, Respondents ("Debtors") brought this preference action in the Bankruptcy Court on July 25, 1991. On January 26, 1993, the Bankruptcy Court entered the "Order Granting Plaintiffs' Motion for Summary Judgment; Order Granting in Part and Denying in Part Defendant's Motion for Summary Judgment", and "Final Summary Judgment".

Maurice appealed the Bankruptcy Court decisions to the District Court pursuant to 28 U.S.C. §158(a). On November 17, 1993, the District Court affirmed the Bankruptcy Court.

Maurice appealed the District Court decision to the Fourth Circuit pursuant to 28 U.S.C. §158(d). On June 23,

1994, the Fourth Circuit affirmed the District Court. On July 7, 1994, Maurice filed its petition for rehearing and suggestion for rehearing *in banc*. On July 26, 1994, the Fourth Circuit entered its order denying Maurice's motion for rehearing and suggestion for rehearing *in banc*. The Court's jurisdiction is invoked pursuant to 28 U.S.C. §1254(1).

## STATUTES INVOLVED

This case involves an action brought by Respondents to recover from Maurice certain payments made by Debtors to Maurice under §547(b) of the Bankruptcy Code, Title 11 of the United States Code.[1] Section 547(b) provides:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made –
>
> (A) on or within 90 days before the date of the filing of the petition; or

[1] References to the "Code" or "Bankruptcy Code" mean the United States Bankruptcy Code, 11 U.S.C. §101 *et seq.*, which is effective for all bankruptcy petitions filed on or after October 1, 1979. P.L. 95-598, 92 Stat. 2549 (November 6, 1978).

(B) between 90 days and one year before the date of the filing of the petition, if such creditor at such time of such transfer was a insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. §547(b). The full text of U.S.C. §547 is set forth in the Appendix at App.-45.

On its face, Code §547(b) authorizes only a trustee to bring an action to avoid a preference. No independent trustee was ever appointed here and this action was brought by Respondents in their capacity as debtors-in-possession. Code §1101 ("Definitions for this chapter") provides that:

In this chapter [11 U.S.C. §1101, *et seq.*] –

(1) "debtor-in-possession" means debtor except when a person that has qualified under section 322 of this title is serving as trustee in this case.

11 U.S.C. §1101(1). The full text of 11 U.S.C. §1101 is set forth in the Appendix at App.-51. In addition, Code §1107(a) ("Rights, powers, and duties of debtor in possession") provides:

Subject to any limitations on a trustee serving in a case under this chapter, and to such

> limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

11 U.S.C. §1107(a). The full text of 11 U.S.C. §1107 is set forth in the Appendix at App.-52.

The power of a trustee to bring an action to recover a preference is subject to the statute of limitations located at Bankruptcy Code §546(a) ("Limitations on avoiding powers"):

> An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of –
>
> (1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202 of this title; or
>
> (2) the time the case is closed or dismissed.

11 U.S.C. §546(a). The full text of 11 U.S.C. §546 is set forth in the Appendix at App.-42.

## STATEMENT OF THE CASE

This case involves a fact pattern that occurs routinely in the thousands of Chapter 11 cases commenced every

year:[2] the debtor-in-possession, as the functional equivalent of a trustee, brings an action to recover an alleged preferential transfer[3] in the administration of the bankruptcy estate. At issue is the proper application of the statute of limitations with respect to a debtor-in-possession, which is not a trustee in name but which is functionally the equivalent to a trustee and exercises "avoiding powers" of a trustee.[4] This is an issue on which the courts of appeals of four circuits are squarely opposed to the decision of the Fourth Circuit.

On October 7, 1988, Maxway Corporation ("Maxway") and its affiliate, Danners, Inc. ("Danners") (collectively "Debtors"), filed voluntary Chapter 11 bankruptcy petitions. No trustee was ever appointed and, as a result, Debtors became and still remain debtors-in-possession.

---

[2] According to statistics complied by the Administrative Office of the United States Courts, 17,690 Chapter 11 bankruptcy petitions were filed in 1988 (the year these bankruptcy cases were commenced) and in 1993 (the last year for which such statistics are available) 19,174 Chapter 11 bankruptcy petitions were filed. The peak year for Chapter 11 petitions filings was 1991: 23,989 Chapter 11 petitions were filed.

[3] In the twelve-month period ending June 12, 1993, 90,803 adversary proceedings were commenced. 47,574 (52%) were to recover money or property. Not all of these actions were preference or even avoidance actions; however, since avoidance actions, and preference actions in particular, are a primary weapon of bankruptcy proceedings, it is safe to assume that the overwhelming majority of such actions were preference or some other avoidance actions.

[4] The power to avoid and recover a preferential transfer is one of the trustee's so-called "avoiding powers"; an action by the trustee to recover property through exercise of an avoiding power is commonly referred to as an "avoidance action".

On October 12, 1988, the Bankruptcy Court appointed the Official Committee of Unsecured Creditors (the "Committee"). On October 25, 1988, the Bankruptcy Court authorized the Committee to retain and employ counsel and accountants.

Substantially all of Danners' assets were liquidated shortly after commencement of the bankruptcy cases. Substantially all of Maxway's assets were liquidated and sold on March 30, 1990. The Debtors and the Committee filed a joint Chapter 11 plan on May 25, 1990 and modifications thereof on June 11 and August 10, 1990 (collectively, the "Plan"), all of which provided that Debtors would not be reorganized but, instead, would be liquidated.

Each version of the Plan and the Bankruptcy Court order confirming the Plan, entered August 13, 1990, authorized the Committee to prosecute all "Avoidance Actions" as defined in the Plan on behalf of and in the name of the Debtors.[5]

Debtors, acting by and through the Committee, commenced this action in the Bankruptcy Court on July 25, 1991, more than two years and eight months after the filing of the bankruptcy petitions. Debtors sought, pursuant to Code §547(b), to recover alleged preferential payments made by Debtors to Maurice. Maurice asserted

---

[5] Pursuant to Code §1123(b)(3), a Chapter 11 plan may provide for the enforcement of a claim or interest of the estate by the debtor, trustee, or another representative of the estate. Pursuant thereto, the Plan and order confirming the Plan provided for the Committee to bring this action on behalf of and in the name of the Debtors.

several defenses, including the running of the statute of limitations. Maurice contended that this action was time-barred since Debtors had failed to bring it by October 7, 1990, that is, two years after the commencement of Debtors' bankruptcy cases.

On January 26, 1993, the Bankruptcy Court entered its order granting Debtors' motion for summary judgment. In connection therewith, the Bankruptcy Court held that Maurice had established the existence of some amounts to reduce the amount of Debtors' claim pursuant to the "subsequent new value" defense of Code §547(c)(4). However, since no one had ever been appointed in the bankruptcy cases with the title of trustee, the Bankruptcy Court rejected Maurice's defense that this action was barred by the statute of limitations of Code §546(a)(1). The Bankruptcy Court further rejected Maurice's contention that the transfers were shielded by the "ordinary course of business" defense of Code §547(c)(2).

Maurice timely appealed the Bankruptcy Court decision to the District Court. On November 17, 1993, the District Court affirmed the Bankruptcy Court.

Maurice timely appealed the District Court's decision. By judgment entered June 23, 1994, the Fourth Circuit declined to address Maurice's other assignments of error and affirmed the decision of the District Court with respect to the applicability of the statute of limitations to Debtors.

The Fourth Circuit held that Code §546(a) is not a "limitation on a trustee" within the meaning of Code §1107(a) and the date on which the statute of limitations

begins to run against both a trustee and debtor-in-possession is the date on which a person bearing the title of trustee is literally "appointed" under the Code §1104. *Infra* at App.-8.

However, the appointment of a trustee strips a debtor of debtor-in-possession status and, therefore, the power to bring an avoidance action. Since a debtor-in-possession and a Code §1104 trustee cannot co-exist, the Fourth Circuit held that a debtor-in-possession is limited by an event which can never occur. As a result, the only time limit on a debtor-in-possession's ability to bring an avoidance action is Code §546(a)(2), that is, the date the case is closed or dismissed. This date is usually many years after commencement of the bankruptcy case (the bankruptcy cases here have been pending almost six years and have not been closed or dismissed).

The Fourth Circuit recognized but rejected the published decisions of four other circuits on the issue in *In re Century Brass Products, Inc.*, 22 F.3d 37 (2d Cir. 1994); *In re Coastal Group, Inc.*, 13 F.3d 81 (3d Cir. 1994); *In re Softwaire Centre International, Inc.*, 994 F.2d 682 (9th Cir. 1993); and *Zilkha Energy Company v. Leighton*, 920 F.2d 1520 (10th Cir. 1990). Since the statute of limitations is "the earlier of" two dates, the statute begins to run on the date the fiduciary representative of the estate is designated and the right to bring an avoidance action accrues, a debtor-in-possession is the functional equivalent of a trustee for purposes of an avoidance action, and Code §1107's plain language expressly makes a debtor-in-possession "subject to any limitation on a trustee", these four other circuits uniformly concluded that a debtor-in-possession is subject to Code §546(a)(1) which begins to run against the

debtor-in-possession on the date it obtains the right to bring an avoidance action. Since a debtor obtains those rights upon filing the bankruptcy petition, the other four circuits uniformly held that the statute of limitations bars an avoidance action by the debtor-in-possession more than two years after commencement of the bankruptcy case.

## REASONS FOR GRANTING THE WRIT

In holding that a debtor-in-possession has the rights, powers and duties of a Chapter 11 trustee, but is not subject to the two-year statute of limitations, the Fourth Circuit rendered a decision that contradicts §1107(a)'s plain language, ignores the structure and text of the Bankruptcy Code, overlooks obvious ambiguities in the Code, and creates a direct conflict with the Second, Third, Ninth, and Tenth Circuits on the proper construction of Code §§ 1107 and 546. The conflict must be resolved as soon as possible since the issue involves construction of national bankruptcy laws that are intended to avoid forum shopping and the fortuity of the jurisdiction determining the result in a particular case. By holding a debtor-in-possession is not subject to the two-year maximum, the Fourth Circuit removed any definable limitation on a debtor-in-possession and, thus, provided that a debtor-in-possession may bring such an action for an unlimited period after the commencement of the bankruptcy case. As a result, creditors and potential defendants have no means of predicting the end of bankruptcy-related litigation by a debtor-in-possession. This issue, which arises in virtually every Chapter 11 case, should

not be the subject of a conflict among five courts of appeals.

## I. THIS CASE PRESENTS AN IMPORTANT AND REOCCURRING QUESTION OF FEDERAL BANKRUPTCY LAW ON WHICH THE COURTS OF APPEAL ARE SQUARELY DIVIDED.

### A. THIS CASE PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH AFFECTS THE ADMINISTRATION OF CHAPTER 11 BANKRUPTCY CASES.

The different constructions adopted by the courts of appeal lead to dramatically different results in cases that are identical except for the identity of the party bringing the avoidance action. The issue in this case involves important issues fundamental to bankruptcy administration that arise in all Chapter 11 bankruptcy cases since every Chapter 11 debtor-in-possession exercises the powers of a trustee and, therefore, the question of the limits on a Chapter 11 debtor-in-possession arises in every Chapter 11 case. Since §546(a) also limits actions under Code §§ 544, 545, 548, and 553, resolution of this issue will affect the outcome of actions brought by debtors-in-possession under each of those Code sections. Many of the largest bankruptcy cases are brought under Chapter 11, and this Court's review is necessary to ensure national uniformity of administration. *Union Bank v. Wolas*, 502 U.S. ___, ___, 112 S.Ct. 527, 529, 116 L.Ed.2d 514, 519-20 (1991); *City of New York v. Saper*, 336 U.S. 328, 329, 69 S.Ct. 554, 555, 93 L.Ed. 710, 714 (1948) (conflict

related to a matter "of considerable practical importance in the administration of the Bankruptcy Act").

### B. THE COURTS OF APPEAL ARE SQUARELY DIVIDED OVER THE ISSUE.

Until the Fourth Circuit issued its decision, the circuits had unanimously concluded that Code §1107(a)'s plain language made a debtor-in-possession, who is the "functional equivalent" of a trustee, subject to §546(a)(1)'s two-year statute of limitations. Since the statute begins to run from the date of a trustee's "appointment" and since a debtor-in-possession and an independent trustee cannot co-exist, the other circuits concluded that the statute of limitations begins to run upon the "appointment" of the debtor to be a debtor-in-possession, which occurs on the date bankruptcy relief is ordered. *In re Century Brass Products, Inc.*, 22 F.3d 37, 39 (2d Cir. 1994) ("We conclude that, in light of the statutory scheme as a whole, §546(a)[(1)] applies to preference-avoidance actions brought by [debtors-in-possession] as well as to those brought by trustees."); *In re Coastal Group, Inc.*, 13 F.3d 81, 87 (3d Cir. 1994) ("For the reasons given above, we hold that the limitations period set forth in 11 U.S.C. §546(a)(1) applies to a debtor-in-possession"); *In re Softwaire Centre International, Inc.*, 994 F.2d 682, 684 (9th Cir. 1993) ("We agree . . . that §546(a), when read in light of §1107(a), was intended to apply to debtors in possession as well as trustees. . . . We conclude, therefore, that

SCI's claims are time barred"); *Zilkha Energy Company v. Leighton*, 920 F.2d 1520, 1524 (10th Cir. 1990) ("We do not believe that Congress intended to limit actions filed by an appointed trustee to two years without making the same restriction apply to a debtor in possession who is the functional equivalent of a trustee. . . . [W]e construe §546(a)(1) to apply to actions filed by a debtor in possession, and we believe the period of limitation begins to run from the date of the filing of a petition for reorganization under chapter 11.").

The Fourth Circuit recognized the authority of the other circuits; however, the Fourth Circuit relied upon authorities rejected[6] and overruled[7] by the other circuits and ignored the bar against the co-existence of a debtor-in-possession and a trustee, and concluded that the Code §546(a)(1) does not apply to a debtor-in-possession. 27 F.3d at 984, App.-10 ("the language of §546(a)(1) is plain; it provides that the two-year statute of limitations for bringing an avoidance action does not begin to run until the appointment of one of the trustees specified in §546(a)(1).").

---

[6] For example, the Fourth Circuit stated that Congress' failure to overrule two bankruptcy court decisions construing Code §546(a) when it amended the Bankruptcy Code in 1984 and 1986 was indicative of Congressional intent. 27 F.3d at 985, n. 3, App.-11, 12. That argument was raised and specifically rejected in *Coastal Group*, 13 F.3d at 85.

[7] For example, the Fourth Circuit cited *In re Hooker Investments, Inc.*, 162 B.R. 426 (Bankr. S.D. N.Y. 1993) as authority that §546(a)(1) does not apply to a debtor-in-possession. 27 F.3d at 981, 984, App.-4, 9. *Hooker Investments* was overruled by *Century Brass, supra*.

Since the only other limit on commencement of a preference action is the date the bankruptcy case is closed or dismissed, the Fourth Circuit rejected a definable deadline for one that is undefinable and which may be 5, 10, or even 20 years after bankruptcy relief is ordered. The date a case will be (if ever) dismissed is wholly unpredictable and since a case will be closed only after the estate is "fully administered", Code §350, the point at which a Chapter 11 case is ever closed is unclear. *See In re Korvettes, Inc.*, 42 B.R. 217, 220 (Bankr. S.D. N.Y. 1984), *reversed on other grounds*, 67 B.R. 730 (S.D. N.Y. 1986).[8]

As a result, the circuits are squarely divided on the issue. Four have concluded that §1107(a)'s plain language means exactly what it says and that a debtor-in-possession is barred from bringing an avoidance action two years after the filing of the petition. The Fourth Circuit has created an exception to Code §1107's plain and unambiguous language and concluded that a debtor-in-possession is not subject to the limitations on a trustee's ability to bring an avoidance action. This creates an undesirable, never ending, undefinable, and unpredictable end to bankruptcy litigation. Therefore, the squarely conflicting constructions of §1107(a) lead to very different results in similar cases and requires resolution by this Court to resolve the split among the circuits. *Barnhill v. Johnson*, 503 U.S. ___, ___, 112 S.Ct. 1386, 1388, 118 L.Ed.2d 39, 45

---

[8] The Fourth Circuit's decision has further implications. Since there is no question that §546(a)(1) is a limitation on a trustee and bars an action by a trustee after two years, the Fourth Circuit judicially created an exception to §1107(a) which by its language permits none. It appears the Fourth Circuit has set precedent to create more exceptions in the future.

(1992); *Dewsnup v. Timm*, 502 U.S. ___, ___, 112 S.Ct. 773, 776, 116 L.Ed.2d 903, 909 (1992); *Segal v. Rochelle*, 382 U.S. 381, 377-78, 86 S.Ct. 511, 514, 15 L.Ed.2d 428, 431-32 (1966); *Katchen v. Landy*, 382 U.S. 323, 326, 86 S.Ct. 467, 470-71, 15 L.Ed.2d 391, 395 (1966).

### C. THE QUESTION PRESENTED ARISES FREQUENTLY WITH DIVIDED RESULTS.

This issue has generated five published decisions by the courts of appeal in three and one-half years (four within 12 months). The issue has been disputed in numerous district and bankruptcy courts with divided results[9] which is an additional basis for granting certiorari. *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 557, 109 S.Ct. 588, 595, 109 L.Ed.2d 588, 595 (1990) (certiorari granted to "address a conflict among the Bankruptcy Courts"). Moreover, the issue continues to be litigated in lower courts in other circuits,[10] with the lower courts merely citing the Fourth Circuit or the other circuits as authority for their conclusions.

---

[9] *See Sparmal Enterprises, Inc. v. Moffit Realty Corp.*, 126 B.R. 559 (S.D. Ill. 1991), *In re Knapp*, 146 B.R. 294 (Bankr. M.D. Fla. 1992), and *In re Lill*, 116 B.R. 543 (Bankr. N.D. Ohio 1990) (two-year limitations applies); *contra In re Mars Stores, Inc.*, 150 B.R. 869 (Bankr. D. Mass. 1993) (listing cases in which the statute of limitations has been at issue).

[10] *See In re Harstad*, 1994 WL 421988, 1994 U.S. Dist. Lexis 11299 (expected to be reported at 170 B.R. 666) (D. Minn. 1994) (two-year limitation applies); *contra In re National Steel Service Center, Inc.*, 1994 WL 456641, 1994 Bankr. Lexis 1248 (expected to be reported at 170 B.R. 745) (Bankr. N.D. Ga. 1994).

Indeed, the conflict on the issue shows no sign of narrowing since there are only two possible answers: either the debtor-in-possession is subject to the limitations on a trustee or it is not.

The decisions of the lower courts have exhaustively canvassed the relevant arguments in favor of and against the various constructions of the statutes involved, so there is no reason to await further consideration of the issue in the lower courts.

The issue is one that will continue to present itself in the thousands of Chapter 11 bankruptcies commenced each year. The conflict will not disappear, as the Fourth Circuit was given a clear opportunity to reconsider its ruling to join with the Second, Third, Ninth, and Tenth Circuits and chose not to do so.

## II. THE FOURTH CIRCUIT ERRED IN ITS CONSTRUCTION OF BANKRUPTCY CODE §§ 1107(a) AND 546(a) AND SHOULD BE REVERSED.

### A. THE FOURTH CIRCUIT ERRED BY IGNORING THE PLAIN LANGUAGE OF CODE §1107(a).

Bankruptcy Code §1107(a) is a two-way street. It grants a debtor-in-possession the powers of a trustee and standing to bring a preference action. Similarly, it makes a debtor-in-possession "[s]ubject to any limitations on a trustee serving in a case in this chapter, and to such limitations or conditions as the court prescribes". In short, it makes a debtor-in-possession the functional equivalent of a trustee for most purposes. *United States v.*

*Whiting Pools, Inc.*, 462 U.S. 198, 201 n. 3, 103 S.Ct. 2309, 2311, 76 L.Ed.2d 515, 519 (1983); *Wolf v. Weinstein*, 372 U.S. 633, 83 S.Ct. 969, 10 L.Ed.2d 33 (1963); *Schokbeton Industries, Inc. v. Schokbeton Products Corp.*, 466 F.2d 171, 174 (5th Cir. 1972) (debtor-in-possession is the "practical equivalent" of a trustee). The Fourth Circuit ignored §1107(a)'s plain language by refusing to hold a debtor-in-possession subject to the statute of limitations of §546(a)(1).

In its decision, the Fourth Circuit ignored settled principles of statutory construction. By ignoring Code §1107(a)'s plain and unambiguous statement that a debtor-in-possession is "[s]ubject to any limitation on a trustee", the Fourth Circuit disregarded this Court's directive that "[t]he plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290, 299 (1989).

To avoid the result required by Code §1107(a)'s plain language, the Fourth Circuit engaged in a tortured analysis and exercise in semantics and stated:

> Subsections (b)-(g) of §546 similarly limit a trustee's – and through operation of §1107, a debtor in possession's – authority to recover property under §§ 544, 545, 547, 548, or 549 [sic]. *See* 11 U.S.C.A. §546(b)-(g). However, unlike the remainder of §546, subsection (a) is not aimed at limiting the authority of trustees to recover property. Rather, it establishes the time period within which an action may be commenced

> under §§ 544, 545, 547, 548, or 553. It provides that no one may bring an avoidance action more than two years after the appointment of enumerated trustees, not that the enumerated trustees may not commence an avoidance action more than two years after their appointment. Thus, by its terms, §546(a) applies both to trustees and debtors in possession, requiring both to commence an action with the specified time periods. The appointment of the various trustees is merely the starting point from which the clock begins to run in paragraph (1).

27 F.3d at 983-84, App.- 7, 8. In other words, part of the Fourth Circuit's rationale is that Code §546(a) is not a "limitation on a trustee" within the meaning of Code §1107(a). However, the Fourth Circuit cited no authority for this conclusion; indeed, it is nothing more than a distinction without a substantive difference.

By definition, a statute of limitations limits the power and ability of any plaintiff to bring a legal action by restricting the time within which the plaintiff may assert the underlying claim. Under "Statute of Limitations" and "Limitation of Actions", *Black's Law Dictionary* refers to the word "Limitations", which is defined as follows:

> Restriction or circumspection; settling an estate or property. A certain time allowed by statute for bringing litigation (*see Statute of Limitations, below*).
>
> * * *
>
> *Limitation of actions. See Statute of Limitations, below.*
>
> * * *

> *Statute of Limitations.* Statutes of the federal government and various states setting maximum time periods during which certain actions can be brought or rights enforced. After the time period set out in the applicable statute of limitations has run, no legal action can be brought regardless of whether any cause of action ever existed.
>
> A statute prescribing limitations to the right of action or certain described causes of action or criminal prosecutions; that is, declaring that no suit shall be maintained on such causes of action, nor criminal charges be made, unless brought with a specified period of time after the right accrued.

*Black's Law Dictionary* (6th ed. 1991). In short, a statute of limitations is a fundamental limitation on any plaintiff because, instead of merely limiting the extent, manner, or process by which a plaintiff exercises a right, it limits the very exercise of the right. Code §546(a) provides that "[a]n action . . . may not be commenced . . . "; this is clearly a "limitation on a trustee", that is, a limitation on the trustee's ability to commence an avoidance action.

That Congress intended such a result in bankruptcy cases is beyond dispute. In addition to its plain language in the context of the Code, the placement of subsection (a) with the balance of §546 under the title "Limitations on avoiding powers" plainly demonstrates Congressional intent that all of §546, not merely some of its subsections, are limitations on a trustee.

The legislative history echoes this intention. *See* H.R. Rep. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess., p. 371 (1977) ("The trustee's rights and powers under certain of the avoiding powers are limited by section 546."); S. Rep. No. 95-989 to accompany S. 2266, 95th Cong., 2d Sess., p. 87 (1978) ("Subsection [(a)] adds a statute of limitations to the use by the trustee of the avoiding powers.").

Simply put, there is no support for the proposition that Code §546(a) is not a limitation on a trustee. The Fourth Circuit's entire decision is flawed since it is beyond dispute that the statute of limitations is a limitation on a trustee which, by the plain language of Code §1107(a), applies to a debtor-in-possession.

### B. THE FOURTH CIRCUIT ERRED BY FAILING TO ANALYZE CODE §546(a)(1) HOLISTICALLY.

Upon concluding that Code §546(a) is not a limitation on a trustee, the Fourth Circuit read §546(a)(1) in isolation. This Court has mandated a holistic approach to construction of the Bankruptcy Code. *King v. St. Vincent's Hospital*, 502 U.S. ___, ___, 112 S.Ct. 570, 574, 116 L.Ed.2d 578, 586 (1991) ("a statute is to be read as a whole, *see Massachusetts v. Marash*, 490 U.S. 107, 115, 109 S.Ct. 1668, 1673, 104 L.Ed.2d 98, 108-109 (1989), since the meaning of statutory language, plain or not, depends on context."); *Kelly v. Robinson*, 479 U.S. 36, 43, 107 S.Ct. 353, 357-58, 93 L.Ed.2d 216, 225 (1986) ("the text is only the starting point. . . . In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and

policy."). As this Court stated in another context concerning the Bankruptcy Code:

> Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme – because the same terminology is used elsewhere in a context that makes its meaning clear . . . or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

*United States Savings Association v. Timbers of Inwood Forest, Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 630, 98 L.Ed.2d 740, 748 (1988); *also see Ron Pair, supra*, at 245, 109 S.Ct. at 1033, 103 L.Ed.2d at 301 (the natural interpretation of the statutory language should not be in conflict "with any other aspect of the Code.").

A court should not reach a decision about §546(a) (limitations on a trustee) until it analyzes its relationship with §547 (creating the cause of action), §1101(1) (appointing a debtor to be a debtor-in-possession unless and until an independent trustee is appointed), and §1107(a) (placing the powers and limitations of a trustee on a debtor-in-possession). This analysis demonstrates that §546(a)(1) must apply to a debtor-in-possession from the date the bankruptcy petition is filed.

On its face, Code §547 (and each Code section creating an avoidance claim) applies, and grants standing, only to a trustee. Bankruptcy Code chapters 7, 12, and 13 require the designation of an independent trustee in every case under those chapters as soon as relief is ordered. Code §§ 701(a), 1202(a), 1302(a). In sharp contrast, Chapter 11 does not provide for the appointment of

an independent trustee when relief is ordered. Instead, Chapter 11 leaves the debtor in charge of case administration and Code §1101(1) confers "debtor-in-possession" status on the debtor.

Code §1107(a) provides that, with enumerated exceptions, a debtor-in-possession has all the rights, powers, duties, and limitations of a Chapter 11 trustee. Therefore, a Chapter 11 debtor, while serving as debtor-in-possession, is the functional equivalent of a trustee, *see United States v. Whiting Pools, Inc., supra; Wolf v. Weinstein, supra,* stands in fiduciary relationship to the bankruptcy estate and the estate's creditors, and enjoys the right and power to bring an avoidance action. *Matter of Hughes,* 704 F.2d 820, 822 (5th Cir. 1983); *In re Chattanooga Wholesale Antiques, Inc.,* 67 B.R. 899, 901 (Bankr. E.D. Tenn. 1986).

No other statute grants this power to a debtor-in-possession; a debtor which lacks debtor-in-possession status is stripped of these powers. *In re Chapel Gate Apartments, Ltd.,* 64 B.R. 569, 576 (Bankr. N.D. Tex. 1986). In most Chapter 11 cases, the debtor-in-possession is the only "trustee" during the administration of the estate. *See In re V. Savino Oil & Heating Co., Inc.,* 99 B.R. 518, 524 (Bankr. E.D. N.Y. 1989) ("The underlying assumption of Chapter 11 is that debtor-in-possession governance is to be the norm.").

Other Code sections provide limitation periods for the assertion of actions. These rights and limitations have been uniformly applied to a debtor-in-possession. *See* Code §549 (two-year limitation period); *In re Flying "S" Land & Cattle Company, Inc.,* 71 B.R. 183, 185 (Bankr. D. Nev. 1987) (debtor-in-possession, but not mere debtor,

may take advantage of §108(a)'s two-year extension of state-law statute of limitations).

The holistic analysis demonstrates that the reference to appointment of a trustee must include the appointment of a debtor-in-possession in order to give meaning to Code §546(a)(1) in most Chapter 11 cases. Otherwise, the two-year limitations period will never run against a debtor-in-possession.

### C. THE FOURTH CIRCUIT ERRED BY FAILING TO RECOGNIZE AND ADDRESS CODE §546(a)'S AMBIGUITY.

To avoid Code §1107(a)'s plain language and the holistic analysis of the Code, the Fourth Circuit held that Code §546(a) is clear and unambiguous. App.-6. In doing so, it ignored obvious inconsistencies in its application which demonstrate its ambiguity and, in doing so, erred in its analysis and conclusion. These ambiguities cannot be the basis of reversing almost 150 years of settled practice that bankruptcy-related actions are subject to a two-year statute of limitations which "have long been integral parts of federal bankruptcy statutes." *Herget v. Central National Bank & Trust Co. of Peoria*, 324 U.S. 4, 5, 65 S.Ct. 505, 506, 89 L.Ed. 656, 659 (1945) (tracing the history of the two-year preference limitations period since 1841 and rejecting an argument to extend it to five years). This Court has been "reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup*

*v. Timm*, 502 U.S. ___, ___, 112 S.Ct. 773, 779, 116 L.Ed.2d 903, 912 (1992).

### 1. The Language of Code §546(a) Demonstrates Its Ambiguity.

In isolation, Code §546(a) is ambiguous. *Zilkha, supra* at 1524. That ambiguity was described by the district court in *Sparmal Enterprises, Inc. v. Moffit Realty Corp.*, 126 B.R. 559 (S.D. Ill. 1991):

> The ambiguity in the statute arises from the fact that §546(a) declares that it applies to all actions under §547, but then in §546(a)(1) the "appointment of a trustee" language seemingly precludes the situation where the Bankruptcy Code, under §1107(a), has granted trustee status to a debtor in possession to carry out a §547 preference action. Thus, whether §546 applies to all §547 actions, as implied by §546(a), or only those brought by an appointed trustee, as [implied] by §546(a)(1), is ambiguous.

126 B.R. at 561. The legislative history of §546(a) contains no discussion of this ambiguity.

### 2. Code §546(a)(1)'s Language "after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202" is Ambiguous.

Code §546(a)(1)'s language "after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202" is also ambiguous, since Code §§ 702, 1302, and 1202 are not

concerned with the appointment of a trustee. Instead, §702 governs the *election* or *designation* of a Chapter 7 trustee by creditors of the debtor and §§ 1202 and 1302 provide for the *qualification* of a Chapter 12 or 13 trustee (28 U.S.C. §586(b) provides for the appointment of a "standing" trustee to serve in all cases under Chapters 12 or 13 pending during the trustee's tenure). To underscore the distinction between these terms, §§ 1202 and 1302 provide for the *appointment* of a trustee only if the standing trustee does not qualify; §702 contains no reference to appointment of a trustee but §§ 701 and 703 provide for the appointment of a trustee.

If the word "appointed" is construed narrowly or literally as directed by the Fourth Circuit, the statute of limitations will never begin to run in most Chapter 7, 12, or 13 cases, since most Chapter 7 cases involve administration by an elected or designated trustee, and since the overwhelming majority of Chapter 12 and 13 cases are administered by the standing trustee after he or she qualifies. Such an approach is contrary to settled bankruptcy practice. *See In re Springfield Furniture, Inc.*, 145 B.R. 520 (Bankr. E.D. Va. 1992), and *In re Black & Geddes, Inc.*, 35 B.R. 827, 828-29 (Bankr. S.D. N.Y. 1983) (phrase includes *elected* trustee).

The holistic analysis provides the consistent construction. The common denominator of the referenced sections obviously is not a trustee's literal "appointment" but, instead, is the designation of the permanent representative of the estate who, regardless of its title, has the fiduciary rights, powers, and duties with regard to unsecured creditors. Code §§ 1101(1) and 1107(a) appoint the debtor-in-possession to this role in most Chapter 11

cases upon the commencement of the case. *In re Herberman*, 122 B.R. 273, 281 n. 12 (Bankr. W.D. Tex. 1990) ("It is chapter 11 bankruptcy itself which fundamentally alters the relationship of the debtor to his creditors, converting it into a fiduciary relationship by operation of section 1107"); *In re V. Savino Oil & Heating Co., Inc., supra* at 524.

Once it is established that the word "appointed" cannot have a narrow or literal construction used by the Fourth Circuit, and means the designation of the permanent representative of the estate, it becomes clear that the word includes the grant of power and duties under Code §§ 1101(1) and 1107(a). Thus, as the other four circuits have recognized, and even if §546(a) is not a "limitation on a trustee" as proclaimed by the Fourth Circuit, the only construction of Code §546(a) which produces consistent results is that all of §546(a), including §546(a)(1), applies to a debtor-in-possession from the date of the filing of the petition.

Code §1107's legislative history supports this construction:

> This section places a debtor-in-possession in the shoes of a trustee *in every way*. He is given the rights and powers of a chapter 11 trustee. He is required to perform the functions and duties of a chapter 11 trustee (except the investigative duties). He is also subject to any limitations on a chapter 11 trustee, and to such limitations and conditions as the court prescribes. *c.f. Wolf v. Weinstein*, 372 U.S. 633, 649-650 (1963).

Rep. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess., p. 404 (1977); S. Rep. 95-989 to accompany S. 2266, 95th Cong., 2d Sess., p. 116 (1978) (emphasis added); *also*

*see* H.R. Rep. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess., pp. 360-363 (1977); S. Rep. 95-989 to accompany S. 2266, 95th Cong., 2d Sess., p. 76 (1978) ("The debtor is given no greater rights . . . than the trustee, and thus, the debtor's avoiding powers under proposed sections 544, 545, 547, and 548, are subject to proposed 546, as are the trustee's powers.").

### D. THE FOURTH CIRCUIT'S DECISION LEADS TO ABSURD RESULTS NOT INTENDED BY THE DRAFTERS.

The Fourth Circuit would hold that a statute of limitations does not begin to run against a debtor-in-possession except upon the literal appointment of a person designated with the title of "trustee". Even if Code §546(a) were unambiguous or was not a limitation on a trustee, the Fourth Circuit's decision leads to absurd results not intended by the drafters.

First, if only the "appointment" of a person designated with the title of "trustee" starts the running of the statute of limitations as the Fourth Circuit concluded, the statute of limitations will never begin to run in most Chapter 7, 12, or 13 cases, since §702 provides for the "election" or "designation" of a trustee, and since §§ 1202 and 1302 address the "qualification" of a trustee. Such a result is contrary to settled practice that the statute of limitations runs two years after the election or designation of a Chapter 7 trustee. *In re Springfield Furniture, Inc., supra.*

Second, the Fourth Circuit's statement that a debtor-in-possession's deadline for commencement of an avoidance action is two years after the appointment of a person bearing the title of a Code §1104 trustee is *absolutely meaningless*. The status of debtor-in-possession is mutually exclusive of the appointment of a Code §1104 trustee. *In re T S Industries, Inc.*, 125 B.R. 638, 641 (Bankr. D. Utah 1991); *In re Marker*, 100 B.R. 569, 570 (Bankr. N.D. Ala. 1989). Section 1101(1) and §1107(a) strip a debtor of debtor-in-possession status upon the appointment of a §1104 trustee and, thus, the power to bring an avoidance action. To hold that a debtor-in-possession may not bring an avoidance action two years after the appointment of a §1104 trustee is to place no limit on a debtor-in-possession since the triggering event (the "appointment" of the trustee), either (i) never occurs, or (ii) occurs and thereby *immediately* terminates the debtor's ability to bring the preference action. In either event, the Fourth Circuit would render §546(a)(1) a nullity in debtor-in-possession administration.

## CONCLUSION

This case presents an important and reoccurring question of federal bankruptcy law on which the courts of appeal are squarely divided. The issue, which relates to the powers and limits of power of a debtor-in-possession acting as the functional equivalent of a trustee in an avoidance action, affects the administration of virtually every Chapter 11 case and, thus, has arisen many times and continues to arise with divided results. Moreover, as

discussed herein, the decision of the Fourth Circuit is incorrect and should be reversed.

For the reasons cited herein, Maurice Sporting Goods, Inc., Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-captioned case on June 23, 1994. In the event the petition is granted, Maurice prays that the judgment of the United States Court of Appeals for the Fourth Circuit be reversed and that this action be remanded with instructions that this action be dismissed with prejudice.

This the 5th day of October, 1994.

Respectfully submitted,

JOHN HENDERSON HASTY
Counsel of Record

KIRBY TODD PHILLIPS
WAGGONER, HAMRICK, HASTY,
MONTEITH & KRATT
Suite 2500
Two First Union Center
Charlotte, North Carolina 28282
Telephone: (704) 332-6141
Telecopier: (704) 375-5102

*Attorneys for Petitioner*

**PUBLISHED**

**UNITED STATES COURT OF APPEALS**
**FOR THE FOURTH CIRCUIT**

| | |
|---|---|
| In Re: MAXWAY CORPORATION;<br>In Re: DANNERS, INCORPORATED,<br>*Debtors.* | |
| MAURICE SPORTING GOODS, INCORPORATED,<br>*Plaintiff-Appellant,*<br>v.<br>MAXWAY CORPORATION, by and through their Official Committee of Unsecured Creditors; DANNERS, INCORPORATED, by and through their Official Committee of Unsecured Creditors,<br>*Defendants-Appellees.* | No. 93-2552 |

Appeal from the United States District Court
for the Western District of North Carolina, at Charlotte.
Robert D. Potter, District Judge.
(CA-93-39-P, BK-88-1027-C-B, BK-88-1026-C-B)

Argued: May 11, 1994

Decided: June 23, 1994

Before WILKINS, Circuit Judge, and SPROUSE and CHAPMAN, Senior Circuit Judges.

Affirmed by published opinion. Judge Wilkins wrote the opinion, in which Senior Judge Sprouse and Senior Judge Chapman joined.

---

## COUNSEL

**ARGUED:** Kirby Todd Phillips, WAGGONER, HAMRICK, HASTY, MONTEITH & KRATT, Charlotte, North Carolina, for Appellant. Rebecca Sofley Henderson, DURHAM, WYCHE, STORY, WHITLEY & HENDERSON, L.L.P., Charlotte, North Carolina, for Appellees. **ON BRIEF:** John H. Hasty, G. Bryan Adams, III, WAGGONER, HAMRICK, HASTY, MONTEITH & KRATT, Charlotte, North Carolina, for Appellant. Albert F. Durham, DURHAM, WYCHE, STORY, WHITLEY & HENDERSON, L.L.P., Charlotte, North Carolina, for Appellees.

---

## OPINION

WILKINS, Circuit Judge:

During the bankruptcy proceedings of Maxway Corporation and Danners, Incorporated (collectively "Debtors"), the Official Committee of Unsecured Creditors (the Committee) brought this action against Maurice Sporting Goods, Incorporated (Maurice), seeking to avoid and recover, as preferential transfers, Debtors' payments to Maurice made during the 90-day period prior to the filing of Debtors' bankruptcy petitions. *See* 11 U.S.C.A. § 547 (West 1993). The bankruptcy court granted summary judgment for the Committee in the amount of $543,038.92, and the district court affirmed. On appeal,

Maurice principally argues that the Committee's avoidance action is barred by the two-year statute of limitations set forth in 11 U.S.C.A. § 546(a)(1) (West 1993). We reject Maurice's contention that the two-year statute of limitations in § 546(a)(1) begins to run against a debtor in possession upon the filing of a Chapter 11 bankruptcy petition and therefore affirm.

## I.

Debtors operated discount department stores in North Carolina. Maurice, a sporting goods distributor, sold merchandise to Debtors on open account. After receiving an invoice from Maurice, Debtors ordinarily made payment within four months, indicating the invoice paid on the check voucher. Between July 18, 1988 and September 7, 1988, a period in which Debtors were experiencing extreme financial difficulty, Debtors made eight separate payments to Maurice.

On October 7, 1988, Debtors voluntarily filed bankruptcy petitions for Chapter 11 reorganization. During the postpetition period, Debtors continued to manage their property as debtors in possession; a trustee was never appointed. Because postpetition revenues were insufficient to fund a reorganization, the bankruptcy court confirmed a plan in August 1990 that provided for the liquidation of Debtors' assets. The plan also authorized the Committee to file actions on behalf of Debtors for the benefit of the estate.

On July 25, 1991, over two years after the petitions were filed but prior to the close of the case, the Committee filed this action, seeking to recover the payments

Debtors made to Maurice during the 90 days prior to the petition date. On cross motions for summary judgment, the bankruptcy court granted judgment in favor of the Committee in the amount of $543,038.92. After conducting a de novo review, the district court affirmed.

II.

The issue presented is whether the two-year statute of limitations for bringing avoidance actions begins to run upon the "appointment" of a debtor in possession, *i.e.*, the filing of a Chapter 11 bankruptcy petition. *See* 11 U.S.C.A. § 1101(1) (West 1993). Although it is one of first impression in this circuit, numerous other courts have addressed this issue. Relying on the plain language of § 546(a)(1), the overwhelming majority of bankruptcy and district courts have concluded that the two-year statute of limitations begins to run only upon the appointment of one of the trustees specified in § 546(a)(1). *See, e.g., Bonwit Teller, Inc. v. Jewelmasters (In re Hooker Invs., Inc.)*, 162 B.R. 426 (Bankr. S.D.N.Y. 1993) (listing cases); *Brin-Mont Chems., Inc. v. Worth Chem. Corp. (In re Brin-Mont Chems., Inc.)*, 154 B.R. 903 (M.D.N.C. 1993) (same). However, the four Courts of Appeals that have addressed the issue have concluded that the two-year statute of limitations begins to run against a debtor in possession upon the filing of a Chapter 11 bankruptcy petition. *See U.S. Brass & Copper Co. v. Caplan (In re Century Brass Prods., Inc.)*, 1994 WL 131182 (2d Cir. Apr. 13, 1994); *Construction Mgt. Servs., Inc. v. Manufacturers Hanover Trust Co. (In re Coastal Group, Inc.)*, 13 F.3d 81 (3d Cir. 1994); *Upgrade Corp. v. Government Tech. Servs., Inc. (In re Softwaire Centre Int'l, Inc.)*, 994 F.2d 682 (9th Cir. 1993); *Zilkha Energy Co. v.*

*Leighton*, 920 F.2d 1520 (10th Cir. 1990). We review de novo the conclusion of the bankruptcy court that the two-year statute of limitations in § 546(a)(1) begins to run only upon the appointment of one of the trustees specified in § 546(a)(1). *See Canal Corp. v. Finnman (In re Johnson)*, 960 F.2d 396, 399 (4th Cir. 1992).

A.

Statutory interpretation necessarily begins with an analysis of the language of the statute. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985). If the language is plain and "the statutory scheme is coherent and consistent," there is no need to inquire further. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-41 (1989). "[T]he sole function of the courts is to enforce [the statute] according to its terms." *Caminetti v. United States*, 242 U.S. 470, 485 (1917). Therefore, courts should venture beyond the plain meaning of the statute only in those rare instances in which there is a clearly expressed legislative intent to the contrary, *Russello v. United States*, 464 U.S. 16, 20 (1983), in which a literal application of the statute would thwart its obvious purpose, *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982), or in which a literal application of the statute would produce an absurd result, *United States v. American Trucking Ass'ns*, 310 U.S. 534, 543 (1940).

Section 546(a) of the Bankruptcy Code provides:

> An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of –

> (1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202 of this title; or
>
> (2) the time the case is closed or dismissed.

11 U.S.C.A. § 546(a) (West 1993). The language of the statute is clear on its face. It requires that an avoidance action under §§ 544, 545, 547, 548, or 553 be commenced within two years after the appointment of one of the specified trustees or prior to the close or dismissal of the case, whichever occurs earlier. Under this plain language, the Committee's avoidance action was timely filed because a trustee had not been appointed and the action was commenced prior to the close or dismissal of the case.

Nonetheless, Maurice argues that the plain language of the statute cannot be given effect because it is inconsistent with the language of 11 U.S.C.A. § 1107(a) (West 1993) and contrary to clearly expressed legislative intent regarding the purpose of § 1107(a). Section 1107(a) provides:

> Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

11 U.S.C.A. § 1107(a). By its terms, § 1107(a) provides that the rights, powers, and duties conferred upon a debtor in possession are subject to any limitations on a Chapter 11 trustee. Moreover, in the legislative history of § 1107(a), Congress stated that § 1107(a) "places a debtor in possession in the shoes of a trustee in every way. . . . He is . . . subject to any limitations on a chapter 11 trustee." S. Rep. No. 95-989, 95th Cong., 2d Sess. 116 (1978) *reprinted in* 1978 U.S.C.C.A.N. 5787, 5902. Maurice argues that an application of the plain meaning of § 546(a)(1) is inconsistent with the language of and contrary to the legislative history of § 1107(a) because it affords debtors in possession greater rights than Chapter 11 trustees. This is so, Maurice asserts, because debtors in possession are foreclosed from bringing avoidance actions only upon the close or dismissal of the case, whereas Chapter 11 trustees are additionally prohibited from commencing avoidance actions more than two years after their appointment. For this reason, Maurice contends that the two-year statute of limitations in § 546(a)(1) should be interpreted as beginning to run upon the "appointment" of a debtor in possession. And, because the Committee's action was commenced more than two years after the filing of Debtors' petitions, Maurice maintains that the action is untimely.

We believe that Maurice's argument misconstrues the function and interaction of §§ 546(a) and 1107(a). Section 1107(a) confers upon a debtor in possession the power and authority of a Chapter 11 trustee. The operation of § 1107(a) thus provides standing to debtors in possession to seek the avoidance of preferential transfers even though § 547 explicitly refers only to trustees. Subsections

(b)-(g) of § 546 similarly limit a trustee's – and through the operation of § 1107, a debtor in possession's – authority to recover property under §§ 544, 545, 547, 548, or 549. *See* 11 U.S.C.A. § 546(b)-(g) (West 1993). However, unlike the remainder of § 546, subsection (a) is not directed at limiting the authority of trustees to recover property. Rather, it establishes the time period within which an action may be commenced under §§ 544, 545, 547, 548 or 553. It provides that no one may bring an avoidance action more than two years after the appointment of the enumerated trustees, not that the enumerated trustees may not commence an avoidance action more than two years after their appointment. Thus, by its terms, § 546(a) applies both to trustees and debtors in possession, requiring both to commence an action within the specified time periods. The appointment of the various trustees is merely the starting point from which the clock begins to run in paragraph (1). Accordingly, an application of the plain language of § 546(a)(1) is not, in our view, inconsistent with the general statutory scheme of functional equivalency established by the language and legislative history of § 1107(a).

Also, our conclusion that the statute of limitations contained in § 546(a)(1) does not begin to run upon the "appointment" of a debtor in possession is consistent with the congressional decision that the statute of limitations should not begin to run upon the appointment of some types of trustees. For example, when a debtor files a voluntary petition for relief under Chapter 7, the United States trustee appoints an interim trustee pursuant to 11 U.S.C.A. § 701 (West 1993). *See* 11 U.S.C.A. § 301 (West 1993). Yet, the two-year limitations period for filing an

avoidance action does not begin to run until a permanent trustee is selected pursuant to 11 U.S.C.A. § 702 (West 1993). *See* 11 U.S.C.A. § 546(a)(1); *see also Kroh v. T.R.M. Mfg. (In re Conco Bldg. Supplies, Inc.)*, 102 B.R. 190 (Bankr. 9th Cir. 1989). Generally, interim trustees assume the limited role of performing administrative functions and preserving the assets of the estate. *See* 4 Lawrence P. King, *Collier on Bankruptcy*, ¶ 701.01 (15th ed. 1994). Thus, they are not as likely as § 702 trustees to commence avoidance actions. Similarly, debtors in possession are not likely to commence avoidance actions, if for no other reason, because they are normally more interested in preserving relationships with their creditors than in maximizing the size of the estate. *See, e.g., In re Hooker*, 162 B.R. at 437; *Katon v. International Bank of Miami, N.A. (In re Tamiami Range & Gun Shop, Inc.)*, 130 B.R. 617, 619 (Bankr. S.D. Fla. 1991) (recognizing that a debtor in possession may also actively seek to delay a Chapter 11 administration beyond the two-year statute of limitations without pursuing an avoidance action in order to bar action against family or friends).[1] In both instances, postponing

---

[1] Maurice asserts that a potential conflict of interest or lack of diligence on the part of a debtor in possession does not support a plain meaning interpretation of § 546(a)(1) because Congress has provided other remedies in the event that a debtor in possession refuses to bring an avoidance action or causes delay in the administration of the estate. For example, a trustee may be appointed in a Chapter 11 reorganization for cause at any time, 11 U.S.C.A. § 1104(a)(1) (West 1993); if a debtor in possession unreasonably delays the administration of the estate, the case may be converted to a Chapter 7 liquidation, 11 U.S.C.A. § 1112(b)(3) (West 1993); and if a debtor in possession fails to bring an avoidance action, a creditors' committee may be

the start of the two-year statute of limitations until the appointment of a trustee who is likely to bring an avoidance action prevents any delay in the commencement of such an action from penalizing unsecured creditors who would benefit from the recovery of a preferential or fraudulent transfer.

B.

In sum, we recognize that the question presented is difficult and that legitimate policy arguments exist on both sides. However, the language of § 546(a)(1) is plain; it provides that the two-year statute of limitations for bringing an avoidance action does not begin to run until the appointment of one of the trustees specified in § 546(a)(1). Application of the plain language of § 546(a)(1) in Chapter 11 cases would not produce an absurd result, nor is it inconsistent with the language of or contrary to the legislative history of § 1107(a). And, as demonstrated by the operation of § 546(a)(1) in Chapter 7 liquidations, interpreting the two-year statute of limitations as not beginning to run upon the filing of a Chapter 11 petition is consistent with the statutory scheme of limiting the time within which avoidance actions may be commenced without causing undue prejudice to unsecured creditors. Further, a debtor in possession's lack of incentive to prosecute avoidance actions establishes a strong basis for not beginning the clock upon the

---

appointed to bring an action on behalf of the estate, 11 U.S.C.A. § 1103(c)(2) (West 1993). None of these provisions, however, remedies the time lost due to any impropriety on the part of the debtor in possession.

"appointment" of a debtor in possession.[2] Additionally, we note that Maurice has not argued that the plain meaning of § 546(a)(1) is contrary to the legislative history of § 546(a)(1)[3] or that an application of the plain language of

---

[2] Moreover, at least one court has concluded that the doctrine of laches applies to limit the time period within which a debtor in possession may bring an avoidance action. *See In re Brin-Mont*, 154 B.R. at 907. Because Maurice did not raise the doctrine of laches on appeal, we need not address this issue.

[3] The legislative history of § 546(a)(1) is at best inconclusive. *See* S. Rep. No. 95-989, 95th Cong., 2d Sess. 87 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5872. The only other available evidence of congressional intent suggests that Congress did not intend the two-year statute of limitations to begin to run against debtors in possession upon the filing of a petition. Under the Bankruptcy Act, a trustee had only two years to bring a preference action, but this two-year period was tolled during the pendency of a reorganization case. *In re Hooker*, 162 B.R. at 436. When Congress enacted the Bankruptcy Code, it eliminated the tolling provision for trustees, but did not address such a change for debtors in possession. The absence of any congressional action on this point evinces an intent to continue to "toll" the limitations period in Chapter 11 reorganizations unless and until a trustee is appointed. *See Dewsnup v. Timm*, 112 S. Ct. 773, 779 (1992) (stating that courts should be reluctant to "interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative hsitory").

Further, by the time Congress promulgated amendments to the Bankruptcy Code in 1984 and again in 1986, bankruptcy courts had held that the two-year statute of limitations in § 546(a)(1) does not begin to run in Chapter 11 cases upon the "appointment" of a debtor in possession. *See, e.g., Windstein v. Berry (In re Steel, Inc.)*, 55 B.R. 426 (Bankr. E.D. La. 1985); *Alithochrome, Corp. v. East Coast Finishing Sales Corp. (In re Alithochrome, Corp.)*, 53 B.R. 906 (Bankr. S.D.N.Y. 1985); *Boatman*

the statute would thwart an obvious purpose of § 546(a)(1). For these reasons, we conclude that the bankruptcy court properly interpreted the two-year statute of limitations in § 546(a)(1) as beginning to run only upon the appointment of one of the trustees specified in § 546(a)(1). Because a trustee had not been appointed when the action was filed, the Committee's action is not time barred.

## III.

After reviewing Maurice's remaining contentions regarding the denial of its motion to strike and the propriety of the grant of summary judgment for the Committee, we conclude that they are without merit. Accordingly, we affirm.

*AFFIRMED*

---

*v. E.J. Davis Co. (In re Choice Vend, Inc.)*, 49 B.R. 719 (Bankr. D. Conn. 1985); *J.E. Jennings, Inc. v. William Carter Co. (In re J.E. Jennings, Inc.)*, 46 B.R. 167 (Bankr. E.D. Pa. 1985); *Edleman v. Gleason (In re Silver Mill Frozen Foods, Inc.)*, 23 B.R. 179 (Bankr. W.D. Mich. 1982); *One Mktg. Co. v. Addington & Assocs. (In re One Mktg. Co.)*, 17 B.R. 738 (Bankr. S.D. Tex. 1982). If Congress had intended a contrary interpretation of § 546(a)(1), it could have amended § 546(a)(1) to overrule these cases – particularly in 1986, when it amended § 546(a)(1) by adding the reference to § 1202. But, it did not. We recognize that both of these arguments rely on congressional silence or inaction and as such they constitute modest evidence of what Congress intended. However, as we stated at the outset, these episodes of silence or inaction constitute the only available evidence of congressional intent.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

3:93CV39-P

| | |
|---|---|
| MAURICE SPORTING GOODS, INC., Plaintiff, v. MAXWAY CORPORATION, and DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS, Defendants. | ORDER |

(Filed Nov. 17, 1993)

THE MATTER is before the Court on appeal by Maurice Sporting Goods, Inc. (Appellant) from an order entered January 26, 1993 by United States Bankruptcy Court Judge George R. Hodges. On May 10, 1993, Appellant filed its brief in support of this appeal. Appellee responded in a brief filed June 4, 1993. Appellant's reply brief was filed June 21, 1993. On August 13, 1993, Appellant sent a letter to this Court to point out relevant Ninth Circuit authority concerning the applicability of the statute of limitations provided for in 11 U.S.C. § 546(a)(1) to debtors-in-possession. The Court has considered that letter and the case submitted by it and will treat this letter as a supplemental brief.

The Court has conducted a careful and thorough *de novo* review of the legal conclusions rendered by the

Bankruptcy Court and has conducted a similar review of that Court's factual findings. Having reviewed this appeal, the Court concludes no reversible error is presented. The Court finds Judge Hodges correctly held that the statute of limitations provided for in 11 U.S.C. § 546(a) does not apply to a debtor-in-possession. The Court also believes Judge Hodges properly admitted Sharon L. Ferrell's affidavit into evidence because it was clearly relevant to the issues before the Court and was not hearsay. The Court further finds the Bankruptcy Court rightly concluded as a matter of law that Appellant received voidable preference payments under the Bankruptcy Code. Finally, the Court concludes the Bankruptcy Court committed no error in deciding that Appellant could not avail itself of the ordinary course of business defense. In sum, the Court affirms the Bankruptcy Court's January 26, 1993 order in its entirety.

**NOW, THEREFORE, IT IS ORDERED** that the Bankruptcy Court's Order granting Appellees' summary judgment motions in the amount of $543,038.92 ($572,470.52 less the amount of $29,431.60 awarded to Appellant reflecting the new value defense) and granting in part and denying in part Appellant's summary judgment motion be, and hereby is, **AFFIRMED IN ITS ENTIRETY.** This appeal is hereby **DISMISSED.**

This the 16th day of November, 1993.

/s/ Robert D. Potter
ROBERT D. POTTER
UNITED STATES
DISTRICT JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

| | |
|---|---|
| In Re:<br>**MAXWAY CORPORATION, DANNERS, INC.,**<br>Debtors. | Case No. C-B-88-01027<br>Case No. C-B-88-01028<br>Chapter 11 |
| **MAXWAY CORPORATION AND DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,**<br>Plaintiffs,<br>v.<br>**MAURICE SPORTING GOODS, INC.,**<br>Defendant. | Adversary Proceeding No. 91-3321<br>JUDGMENT ENTERED ON 1-26-93 |

**ORDER GRANTING PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT; ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION FOR SUMMARY JUDGMENT**

(Filed Jan. 26, 1993)

This cause came on for consideration upon cross motions for summary judgment. Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors, plaintiffs herein ("plaintiffs"),

seek the entry of summary judgment against Maurice Sporting Goods, Inc. ("defendant") in the amount of $543,068.61 under § 547(b) of the Bankruptcy Code.[1] Defendant disputes that plaintiffs have established a right to recover under § 547(b), and further argues that the payments are sheltered under §§ 547(c)(2) and (c)(4) of the Bankruptcy Code.[2] Additionally, defendant argues that the complaint is barred by § 546(a) of the Bankruptcy Code. For the reasons set forth in the following findings of fact and conclusions of law, plaintiffs' motion shall be granted and defendant's motion shall be granted in part and denied in part.[3]

---

[1] In their motion, Plaintiffs seek judgment of $572,470.52. Plaintiffs subsequently acknowledged Defendant's § 547(c)(4) defense to the extent of $29,431.60.

[2] Defendant originally alleged a defense under § 547(c)(1) of the Bankruptcy Code, but withdrew this defense at hearing on the summary judgment motions.

[3] On or about September 14, 1992, this Court issued its Memorandum of Decision in which it determined that Plaintiffs' motion should be allowed and Defendants's motion denied. The Court requested that Plaintiffs' counsel prepare and circulate in accordance with Local Rules a proposed order consistent with the Memorandum of Decision. For purposes of Part VIII, Federal Rules of Bankruptcy Procedure, Appeals to District Court or Bankruptcy Appellate Panel, the time within which either party may file an appeal of this Court's ruling shall begin to run upon the entry of this Order Granting Plaintiffs' Motion for Summary Judgment and Order Granting in Part and Denying in Part Defendant's Motion for Summary Judgment.

## Findings of Fact

All of the following factual findings are of record either by affidavit or by stipulation of the parties and are undisputed. Maxway Corporation ("Maxway") and Danners, Inc. ("Danners") (collectively "debtors"), owners and operators of discount department stores, filed petitions for relief under the provisions of chapter 11 of title 11, United States Code ("Bankruptcy Code") on October 7, 1988 (the "Petition Date"), in the United States Bankruptcy Court for the Western District of North Carolina. Pursuant to an order of this Court confirming the debtors' joint chapter 11 plan, plaintiffs were authorized to file complaints on behalf of and in the name of the debtors to recover all transfers to creditors recoverable under the Bankruptcy Code.

Since at least 1986, defendant, a manufacturer and distributor of sporting goods, sold its products to the debtors on open account, imposing on the debtors a $500,000.00 credit limit. During 1986 and 1987, defendant shipped goods to the debtors on credit and then invoiced the debtors for the shipments. The debtors thereafter submitted payments to defendant by company check, paying the oldest invoices first and indicating the invoices paid on the check voucher attached to the check. This procedure was consistent with the debtors' ordinary payment practices with all trade vendors.

In January of 1988, the defendant became aware that Maxway was experiencing cash flow problems, and as Maxway neared its $500,000.00 credit limit, defendant placed Maxway's orders on a credit hold. In early February of 1988, debtors began sending defendant payments

on account to be applied as a general credit, and over the next sixty days defendant received eight payments on account totalling $320,000.00. In April of 1988 the debtors resumed their usual practice of paying specifically identified invoices.

In July 1988 the debtors continued to suffer severe cash flow shortages which required the debtors to institute a system for prioritizing payments to creditors. On a weekly basis officers of the debtors would project mandatory expenses and estimate cash available for payments to trade vendors. Vendors awaiting payment before shipment of additional necessary goods were listed for payment first, then debtors paid those creditors who were aggressively seeking payment. In September of 1988, debtors had difficulty paying even mandatory expenses, such as rent.

Notwithstanding Maxway's $500,000.00 credit limit with defendant, by July of 1988 the debtors collectively owed defendant $841,795.04, $497,476.90 of which was past due. Once again defendant placed the debtors' account on hold, and the defendant thereafter approved limited shipments. Defendant knew that only preferred creditors were getting paid, and the defendant made numerous calls to the debtors during the preference period in an effort to accomplish payment. On some days the defendant made repeated calls to the defendant inquiring about payment status.

After July 9, 1988, the ninetieth day prior to debtors' bankruptcy, defendant received from debtors eight checks written on the debtors' general operating account which total $572,470.52. The chart below itemizes the

payments to defendant by check number and check amount, and lists the date each check was honored by the debtors' bank.

| Check Number | Check Amount | Honor Date |
|---|---|---|
| 209382 | $75,765.67 | July 19, 1988 |
| 210088 | $70,620.71 | August 4, 1988 |
| 207244 | $72,500.00 | August 10, 1988 |
| 210453 | $77,730.95 | August 10, 1988 |
| 207273 | $75,000.00 | August 18, 1988 |
| 207282 | $75,000.00 | August 26, 1988 |
| 212061 | $75,759.50 | August 31, 1988 |
| 212488 | $50,093.69 | September 7, 1988 |

Each of the payments was made on account of antecedent debt, and was made while the debtors were insolvent. Three of the payments evidenced by checks numbered 207244, 207273, and 207282 in the total amount of $222,500.00, were submitted to defendant as payments "on account."

On July 15, 1988, at least one day prior to defendant's receipt of check numbered 209382, the first payment the plaintiffs seek to avoid, defendant shipped $6,862.66 worth of goods to debtors. After July 19, 1988, the date check numbered 209382 was honored by the debtors' bank, defendant shipped additional goods on credit to the debtors with a value of $29,431.60. In addition, after July 19, 1988, defendant submitted "billback invoices" to the debtors totalling $16,577.17. These billback invoices dispute credits the debtors took for returns and shortages in shipments, and are dated as of the date the defendant notified debtors of the disparities; however, the billback invoices indicate that the goods that were shipped to the

debtors and about which the disputes arose were shipped prior to the preference period.[4] The billback invoices do not evidence any value returned to the estate, but instead reflect a payment demand for goods provided, but not paid for, prior to the preference period.

On July 9, 1988, and at all times thereafter, the debtors were insolvent, with a negative net worth on the Petition Date of at least $12,377,958.00. The payments debtors made to defendant during the preference period constitute approximately 26% of the total debt it was owed. The anticipated dividend to unsecured creditors in this case is at most 5%.

## Conclusions of Law

This Court has jurisdiction over the parties and the subject matter of this proceeding pursuant to 28 U.S.C. §§ 1334, 151 and 157. This proceeding is a "core proceeding" pursuant to 28 U.S.C. § 157(b)(2)(F) which this Court may hear and determine.

F. R. Civ. P. 56, made applicable to this adversary proceeding by F. R. Bankr. P. 7056, provides that judgment shall be entered in favor of a party moving for summary judgment if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving

---

[4] Billback invoices numbered 13610, 13612, and 13609 involve disputes about shipments made after the Defendant's receipt of the first preferential payment. These shipments are included in the $29,431.60 figure.

party is entitled to a judgment as a matter of law." F. R. Civ. P. 56. Summary judgment is appropriate when the evidence, viewed in a light most favorable to the party against whom summary judgment is sought, could not lead a rational fact-finder to find for the non-moving party. *Matusushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). The undisputed facts of this record, viewed in a light most favorable to the defendant, indicate that plaintiffs are entitled to judgment on all issues as a matter of law.

I. Section 546(a)(1) is Inapplicable to this Adversary Proceeding

The overwhelming majority of courts and commentators which have interpreted § 546(a)(1) have held that the time limit imposed by that section is applicable only to a trustee appointed under specific sections of the Bankruptcy Code, and is not applicable to a debtor in possession. *See, e.g., In re Cardullo,* 142 Bankr. 138 (Bankr. E.D. Va. 1992); *In re Hunt,* 136 Bankr. 437 (Bankr.N.D.Tex. 1991); *In re Allegheny International, Inc.,* 136 Bankr. 396 (Bankr. W.D.Pa. 1991); *In re Pullman Construction Industries, Inc.,* 132 Bankr. 359 (Bankr. N.D. Ill. 1991); *In re Tamiami Range and Gun Shop, Inc.,* 130 Bankr. 617 (Bankr. S.D. Fla. 1991); *In re Century Brass Products, Inc.,* 127 Bankr. 720 (Bankr. D. Conn. 1991); *In re Mahoney Trocki & Assoc.,* 111 Bankr. 918 (Bankr. S.D. Cal. 1990); *In re Air One, Inc.,* 75 Bankr. 998 (Bankr. E.D. Missouri 1987); *In re Jet Florida System, Inc.,* 73 Bankr. 552 (Bankr. S.D. Fla. 1987); *In re Korvettes, Inc.,* 67 Bankr. 730 (S.D.N.Y. 1986); *In re Afco Development Corp.,* 65 Bankr. 781 (Bankr. D. Utah

1986); *In re Alithochrome Corp.*, 53 Bankr. 906 (Bankr. S.D.N.Y. 1985); *In the Matter of Choice Vend, Inc.*, 49 Bankr. 719 (Bankr. D. Conn. 1985); *In re J.E. Jennings, Inc.*, 46 Bankr. 167 (Bankr. E.D. Pa. 1985); *In re Steel, Inc.*, 55 Bankr. 426 (Bankr. E.D. La. 1985); *In the Matter of Silver Mills Frozen Foods, Inc.*, 23 Bankr. 179 (Bankr. W.D. Mich. 1982); *In re One Marketing Co., Inc.*, 17 Bankr. 738 (Bankr. S.D. Tex. 1982); G. Triester, J. Trost, L. Foreman, K. Klee and R. Levin, *Fundamentals of Bankruptcy*, ALI-ABA American Law Institute 2d ed., paragraph 4.03(k) (1989); 4 COLLIER ON BANKRUPTCY ¶ 546.02[2] (15th ed. 1990).

This court has previously ruled in related adversary proceedings that § 546(a)(1) is not applicable to the adversary proceedings instituted by the plaintiffs as debtors in possession.[5] The analysis supporting this conclusion is grounded in the plain, unambiguous language of the statute, and in the practicalities attendant to the

---

[5] *Memorandum Opinion* filed May 9, 1991, Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors v. American Gift Corporation, Adv. Proc. No: 91-3025; *Order Granting in Part and Denying in Part the Defendant's Motion for Summary Judgment, Granting the Plaintiffs' Motion for Partial Summary Judgment, and Deferring Ruling on the Plaintiffs' Motion for Summary Judgment* filed July 26, 1991, Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors v. Leonard A. Feinberg, Inc., Adv. Proc. No.: 91-3079; *Memorandum Opinion and Order Granting Plaintiffs' Motion for Summary Judgment or Partial Summary Judgment and Denying Defendant's Motion for Summary Judgment* filed November 7, 1991, Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors v. Kalamazoo Valley Plant Growers Cooperative, Inc., Adv. Proc. No.: 91-3319.

administration of a chapter 11 case by a debtor in possession. Because this adversary proceeding is brought on behalf of and in the name of the debtors as debtors in possession, and not by a trustee appointed under the Bankruptcy Code, as a matter of law, this court concludes that the two year limitation imposed by § 546(a)(1) is inapplicable to this adversary proceeding. The only limitation to the commencement of an adversary proceeding under § 547 of the Bankruptcy Code by a debtor in possession is found in § 546(a)(2), which provides that such actions must be commenced by the time the case is closed or dismissed.

Section 546(a) provides:

> An action or proceeding under section . . . 547 . . . of this title may not be commenced after the earlier of –
>
> (1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302 or 1202 of this title; or
>
> (2) the time the case is closed or dismissed.

The simple, unambiguous language of § 546(a)(1) specifies that it is the appointment of a trustee under § 1104 of the Bankruptcy Code that begins the two year period within which avoidance actions must be instituted in a chapter 11 case. Although the rights, powers and duties of a debtor in possession are in many ways similar to those of a trustee appointed under § 1104, a debtor in possession is not appointed under § 1104. The rights, powers, and duties of a debtor-in-possession originate in § 1107 of the Bankruptcy Code. In fact, § 1104 is the

substantive mechanism by which a debtor is displaced of possession in a chapter 11 case.

*Collier* has long taken the position that

> if a debtor in possession is serving in a case under chapter 11 and no trustee has been appointed, the two year period arguably would not begin to run unless and until a trustee is appointed. The better view is that § 1107(a), which gives the debtor the powers of a trustee and subjects the debtor in possession to the limitations placed on a trustee, does not equate service of the debtor in possession with the appointment of a trustee for the purposes of § 546(a).

4 Collier on Bankruptcy, § 546.02[2] (15th Edition 1990).

Chapters 3 and 5 of the Bankruptcy Code, which are applicable to chapters 7, 9, 11, 12, and 13, confer on a trustee certain rights, powers and duties. Bankruptcy Code § 103. Bankruptcy Code § 323, which defines the role and capacity of a trustee, does not limit its application to trustees appointed under particular Bankruptcy Code sections. "The trustee" may employ professional persons under § 327. "The trustee" may be required to provide adequate protection under § 361. "The trustee" may, or may not, use, sell or lease property of the estate under § 363. "The trustee" may obtain credit under § 364, may assume or reject executory contracts under § 365, and may abandon property of the estate under § 554. The avoidance powers found in §§ 547, 548, and 549 are given to "the trustee", and "the trustee" is given the rights and powers of a judgment lien creditor under § 544. Bankruptcy Code § 546(a) is the only Bankruptcy Code section

empowering or limiting a trustee which also specifically identifies the Bankruptcy Code sections under which the trustee appointment is made. Section 546(a)(1) is simply not ambiguous. Only a trustee appointed *under § 702, 1104, 1163, 1302 or 1202* is subject to the two year statute of limitations found in § 546(a)(1). By § 546(a)(1)'s enumeration of the Bankruptcy Code sections under which a trustee assumes his role, debtors in possession are definitively excluded from its limitation period.

The same analysis has led courts to find that in a chapter 7 case, the two year period does not begin to run upon the appointment of an interim trustee under § 701, but upon the election of a permanent trustee under § 702. *See, e.g., In re Conco Building Supplies, Inc.*, 102 Bankr. 190 (Bankr. App. Pan. 9th Cir. 1989); *In re Nash Phillips/Copus-Houston, Inc.*, 114 Bankr. 466 (Bankr. W.D. Tex. 1990); *In re Metro Shippers, Inc.*, 95 Bankr. 366 (Bankr. E.D. Pa. 1989); *In re Young*, 97 Bankr. 679 (Bankr. N.D. Ga. 1988); *In re Chequers, Ltd.*, 59 Bankr. 177 (Bankr. W.D. Pa. 1986); *In re Sin-Ko, Inc.*, 48 Bankr. 180 (Bankr. N.D. Ohio 1985); *In re Outlet Department Stores, Inc.*, 49 Bankr. 536 (Bankr. S.D.N.Y. 1985); *In re Modern Mix*, 33 Bankr. 543 (Bankr. S.D. AL 1983); *In the Matter of Killian Construction Co., Inc.*, 24 Bankr. 848 (Bankr. D. Idaho 1982) ("I cannot reasonably infer that Congress specifically cited § 702 in § 546(a) without cause."); *In re Black & Geddes, Inc.*, 35 B.R. 827 (Bankr. S.D.N.Y. 1983) (since Congress deleted Sections 701 and 703 from 546 but included the other (then) four appointment sections, "these omissions must be viewed as deliberate indications of legislative intent.")

*In re Korvettes, Inc.*, 67 Bankr. 730 (S.D.N.Y. 1986) is representative of the cases which support the position

that § 546(a)(1) is not applicable to debtors in possession. In *Korvettes,* the district court reversed a bankruptcy court decision in which the bankruptcy court, finding § 546(a)(1) to be ambiguous, held that an action under § 547 which was filed more than two years after the chapter 11 petition was filed and after a plan had been confirmed was time-barred. The district court in *Korvettes* found no ambiguity in the statute, and applied § 546(a)(1) in a manner consistent with its wording. "[§ 546(a)(1)] specifies that the two year period is to begin to run when a trustee is appointed under specific sections of the Code. '[W]hen the express language of a statute is clear, a court will not adopt a different construction absent clear legislative history contradicting the plain meaning of the words.' " *Korvettes,* at 733, citing *United States v. Holroyd,* 732 F. 2d 1122, 1125 (2d Cir. 1984). *See also, Helvering v. City Bank Farmers Trust Co.,* 296 U.S. 85, 89, 56 S.Ct. 70, 72 (1935) ("We are not at liberty to construe language so plain as to need no construction, or to refer to Committee reports where there can be no doubt of the meaning of the words used.") There is no apparent legislative intent to impose the two year limitation of § 546(a)(1) on debtors in possession. The only bar to institution of avoidance actions in a chapter 11 case, where no trustee has been appointed, is the closing or dismissal of the case. Bankruptcy Code § 546(a)(2).

The Bankruptcy Code underwent significant changes in 1984, and in fact, § 546(a)(1) was amended to change the conjunction between subsection (a)(1) and (a)(2) from "and" to "or." Bankruptcy courts had published opinions at the time of the Congressional adoption of the 1984 amendments finding that § 546(a)(1) was inapplicable to

debtors in possession. *See, e.g., In the Matter of Silver Mills Frozen Foods, Inc., supra; In re One Marketing Co., Inc., supra.* Had Congress intended a contrary interpretation of § 546(a)(1), it would have amended § 546(a)(1) to overrule those cases. As stated in *Matter of Choice Vend, Inc.*, 49 Bankr. 719 (Bankr. D. Conn. 1985), a "[c]ourt can presume that Congress is aware of settled judicial construction of existing law, and that it intends to retain those remedies that it has left in place." *Id.*, at 721, citing *Air Transport Association of America v. PATCO*, 667 F.2d 316, 321 (2d Cir. 1981). The court in [sic] *re One Marketing Co., Inc.*, virtually invited Congress to overrule its conclusion. "Section 546(a)(1) specifically mentions trustees appointed under certain sections of the Code, with no mention of section 1107. It seems clear that had the legislature wanted to include section 1107, it could easily have done so." *In re One Marketing Co., Inc., supra*, at 1616.

Again in 1986, Congress added "1202" to § 546(a)(1). At least four additional courts had published opinions at the time of the Congressional adoption of this amendment finding that § 546(a)(1) was inapplicable to debtors in possession. *In re Korvettes, Inc., supra* (Bankruptcy Court opinion); *In re Alithochrome Corp., supra; In the Matter of Choice Vend, Inc., supra; In Re J.E. Jennings, Inc., supra.* Absent clear legislative intent to the contrary, or ambiguity in the statute itself, this Court cannot find that § 546(a)(1) bars an action brought by a debtor in possession.

In addition, policy reasons support his conclusion. The negotiation and confirmation of a chapter 11 plan is often a painstaking, time consuming undertaking. Many chapter 11 cases, including the debtors' cases, contain

complicated legal issues and multifaceted economic considerations. To impose a two year limitation on the institution of avoidance actions would force a debtor in possession to fragment its plan negotiations and definitively address a single issue at an early stage of the proceeding that is better confronted later as part of the entire case.

In the debtors' cases, the "Avoidance Actions," as defined in the debtors' plan, were an integral part of the negotiated confirmed joint plan, and the treatment of the avoidance actions was not determined until August 13, 1990, when this court entered its Order confirming the debtors' joint plan. Institution of these actions by the debtors, prior to confirmation, could have been premature and counterproductive to plan negotiations. In fact, because of the sheer number of these actions, it would have been virtually impossible to conduct the necessary investigation and file these lawsuits within the time frame the defendant is asserting.

This court is aware of *Zilkha Energy Co. v. Leighton*, 920 F.2d 1520 (10th Cir. 1990), wherein the Tenth Circuit, reasoning that a debtor in possession is the functional equivalent of a trustee, determined that § 546(a)(1) applies to debtors in possession. This court does not accept the reasoning of *Zilkha* and declines to follow it. The plain language of § 546(a)(1) indicates that debtors in possession are not limited to the two year statute of limitations imposed on trustees appointed under §§ 702, 1104, 1163, 1302 or 1202 of the Bankruptcy Code. Furthermore, limiting the time frame within which debtors in possession may bring these claims to two years from the petition date is contrary to the purposes of reorganization

in a chapter 11 case and the effective negotiation and confirmation of a chapter 11 plan. For the reasons set forth herein, the Court concludes, as a matter of law, the two year limitation imposed by § 546(a)(1) is inapplicable to debtors in possession and to this adversary proceeding.

II. Transfers are Avoidable Pursuant to § 547(b) of the Bankruptcy Code

11 U.S.C. § 547(b) sets forth the elements of an avoidable preference: (1) any transfer of any interest of the debtor in property; (2) to or for the benefit of a creditor; (3) for or on account of an antecedent debt owed by the debtor before such transfer was made; (4) made while the debtor was insolvent; (5) made on or within ninety days of the filing of the petition; and (6) that enables such creditor to receive more than such creditor would receive if (a) the case were a case under chapter 7 of title 11; (b) the transfer had not been made; and (c) such creditor received payment of such debt to the extent provided by the provisions of title 11. Defendant does not dispute that it received $572,470.52 in the ninety days prior to bankruptcy on account of antecedent debt while the debtors were insolvent. Defendant contests, however, that the payments allowed defendant to receive more than defendant would have received if the case were a case under chapter 7 and the payments had not been made.

In *Palmer Clay Products Co. v. Brown*, 297 U.S. 227 (1936), the Supreme Court, in construing § 60(a) of the Bankruptcy Act, the predecessor statute to § 547, held that a payment to an unsecured creditor always allows

that creditor to receive more than others of its class if the distribution in bankruptcy is less than 100%. *Id.*, at 229. The Fourth Circuit has recently adopted the *Palmer Clay* analysis in the case of *In re Virginia-Carolina Financial Corporation*, 954 F.2d 193 (4th Cir. 1992). The debtors were insolvent at the time of each payment to the defendant, with the sum of their debts exceeding the value of their assets. Hypothetically, if the debtors' assets were liquidated on the date of each transfer and distributed in accordance with creditors' chapter 7 distribution priority, defendant, an unsecured creditor at the end of the distribution line, would have received less than 100%. Defendant admits that in fact it received 26% of its outstanding claim, more than five times the estimated distribution to creditors in this case. Defendant's receipt of $572,470.52 in the ninety days prior to bankruptcy was more than what defendant would have received in a chapter 7 distribution if the payments had not been made.

III. Defendant's § 547 (c) Defenses

A. Payments Were Not Made in the Ordinary Course of Business

One of the purposes of § 547 is to advance a primary objective of the bankruptcy proceeding, equality of distribution to all creditors. *In re Jeffrey Bigelow Design Group Inc.*, 956 F.2d 479 (4th Cir. 1992). The exceptions to § 547 are narrow, and are designed to shelter only those transactions which do not impede this fundamental goal. The particular objective of the ordinary course of business exception to § 547 is "to discourage unusual action by either the debtor or its creditors during the debtor's slide

into bankruptcy." *Id.*, at 487. Accordingly, ordinary course is a factual analysis which requires an examination of the circumstances under which payments were made and a comparison of those circumstances with previous transactions between the debtor and the transferee. *In the Matter of J.P. Fyfe, Inc. of Florida*, 891 F.2d 66 (3rd Cir. 1989); *In re Fulghum Constr. Corp.*, 872 F.2d 739 (6th Cir. 1989); *In re First Software Corp.*, 81 Bankr. 211 (Bankr. D. Mass. 1988). In order to show ordinary course the transferee must demonstrate that the payment was normal and customary between the parties. An appropriate gauge is how the parties dealt with the payments when payments were thought to be made under normal circumstances.

In 1986 and 1987, before the debtors began their marked financial decline, defendant shipped goods to the debtors on credit and then invoiced the debtors for the shipments. The debtors thereafter submitted payments to defendant by company check, paying the oldest invoices first and indicating the invoices paid on the check voucher attached to the check. This procedure was consistent with the debtors' ordinary payment practices not only with the defendant but also with all trade vendors; however, this payment process was not followed during the preference period.

During the preference period, defendant made repeated telephone calls to debtors soliciting payments and limited its new shipments. Even if the phone calls were not threatening or harassing in nature, they induced debtors to put the defendant on a payment priority list created by the debtors in order to make the most effective use of the limited cash available. Debtor abandoned its ordinary practice on paying specific invoices and instead

made large payments to defendant "on account." This evidence, coupled with the statements of Sharon Ferrell, the chief financial officer of the debtors in 1988, who indicates that the debtors literally preferred some creditors over others, establishes that defendant gained an advantage over other creditors. The payments were not made in the ordinary course of business between the parties nor according to ordinary business terms.

Defendant argues that the payments made on account were in the ordinary course of business because they were consistent with an alleged agreement negotiated between the parties in January, 1988, five months prior to the preference period. Even assuming that this payment schedule and procedure was an agreement of the parties, this practice was initiated upon defendant's actual notice of the debtors' financial difficulty, and was not consistent with the parties' payment customs before the debtors' financial problems arose. It was a "new" deal, and a direct result of the debtors' escalating economic crisis. Payments on account were not normal practice between defendant and the debtors prior to the alleged agreement in January, 1988, and clearly it was never ordinary for the debtors in their transactions with other creditors to pay "on account." Thus, payments on account were not in the ordinary course of business under § 547(c)(2).

Case law supports this conclusion. In *re Day Telecommunications, Inc.*, 70 Bankr. 905 (Bankr. E.D.N.C. 1987), the court held that a transfer resulting from the transferee's insistence upon payment of the bill was not an ordinary course of business transaction, and allowed summary judgment in favor of the trustee on this issue. Other

courts have similarly held that a payment made in response to pressure by the transferee does not fall within the exception of § 547(c)(2), because the payment was not made in the ordinary course of business. In *In re Family Home Sales Center, Inc.*, 65 Bankr. 176 (Bankr. N.D. Ga. 1986), a creditor refused to take another order until the debtor paid for previous shipments. The court, in granting summary judgment in favor of the trustee, found that "[e]xercise of leverage or pressure by the creditor on the debtor to make a payment is a factor in deciding whether the transfer was in the ordinary course of business." *Id.*, at 178, citing *In re Production Steel, Inc.*, 54 Bankr. 417 (Bankr. M.D. TN. 1985) and *In re Brenton's Cove Development Co.*, 52 Bankr. 287 (Bankr. D.R.I. 1985).

"The purpose of [§ 547(c) (2)] is to leave undisturbed normal financial relations while prohibiting any unusual conduct which allows the creditor connected with the transfer to gain an advantage over other creditors." *In re Day Telecommunications, Inc., supra,* at 910, citing *In re Economy Milling Co.*, 37 Bankr. 914 (D.S.C. 1983). See also *In re Jeffrey Bigelow Design Group, Inc., supra,* in which the Court generally discusses the purposes behind the ordinary course of business exception. Defendant accomplished payment by repeated telephone calls and by reducing shipments without payment, which clearly gave defendant an advantage over other creditors. The effectiveness of defendant's economic pressure is evidenced by defendant's receipt of $50,000.00 on September 6, 1988, at a time when the debtors had trouble paying even their mandatory expenses, such as rent. The undisputed facts of this record, when viewed in a light most favorable to

defendant, could not reasonably lead a fact-finder to conclude that defendant is entitled to § 547(c)(2)'s shield.

B. Payments Were Followed by Limited Extensions of Credit

Creditors who receive avoidable payments during the preference period, and who thereafter provide goods and services on credit to the debtor, are given limited protection by § 547(c)(4). Section 547(c)(4) promotes equality of treatment among creditors by limiting the new value defense to the extent to which the estate was replenished by the creditor's subsequent advances during the preference period. 4 COLLIER ON BANKRUPTCY ¶ 547.12, n. 5.

In order to determine whether defendant is entitled to assert a defense pursuant to § 547(c) (4), it is necessary to examine each transfer and determine whether after each such transfer, defendant extended additional unsecured credit and, if so, the amount thereof. "[T]he proper mode of analysis is that after each preferential payment, an assessment must be made as to how much property the creditor restored to the debtor. . . ." *Leathers v. Prime Leather Finishes Co.*, 40 Bankr. 248, 251 (D. Me. 1984). *See also, In re Meredith Manor, Inc.*, 902 F.2d 257 (4th Cir. 1990); *Charisma Investment Co., N.V. v. Air Florida System, Inc.*, 68 Bankr. 596 (S.D. Fla. 1986), *aff'd sub nom., Charisma Investment Co., N.V. v. Airport Systems*, 841 F.2d 1082 (11th Cir. 1988); *In re Paula Saker & Co.*, 53 Bankr. 630, 634 (S.D.N.Y. 1985).

Plaintiffs concede that defendant is entitled to a defense for new value in the amount of $29,431.60. Defendant argues entitlement to an additional $16,577.17 for "billback invoices," and an additional $6,862.66 for goods invoiced to debtors on July 15, 1988.

The billback invoices represent credits the debtors took for returns and shortages in shipments, which the defendant disputed, and accordingly billed back to the debtors. The billback invoices are dated as of the date the defendant notified debtors of the alleged disparities; however, the billback invoices indicate that the goods that were shipped to the debtors and about which the disputes arose were shipped *prior* to the preference period, with three exceptions.[6] The billback invoices do not evidence any value returned to the estate, but instead reflect a payment demand for goods provided, but not paid for, before the preference period.

The great majority of courts addressing this issue have concluded that the subsequent advance contemplated by § 547(c)(4) must return the value of an earlier preference to the debtor's estate. *In re Hancock-Nelson Mercantile Co., Inc.*, 122 Bankr. 1006 (Bankr. D. Minn. 1991). *See, also, In re Prescott*, 805 F.2d 719, 731 (7th Cir. 1986); *In re Global International Airways Corp.*, 80 Bankr. 990, 992 at n. 4 (Bankr. W.D. Mo. 1987); *In re Ford*, 98 Bankr. 669, 681 (Bankr. D. Vt. 1989); *In re American International Airways, Inc.*, 56 Bankr. 551, 554-55 (Bankr. E.D.

---

[6] Billback invoice numbers 13610, 13612 and 13609 involve disputes about shipments made after the Defendant's receipt of the first preferential payment, and these invoices are included in the $29,431.60 conceded by the Plaintiffs.

Pa. 1986); *In re White River Corp.*, 50 Bankr. 403, 409-10 (Bankr. D. Colo. 1985); *In re Formed Tubes, Inc.*, 46 Bankr. 645, 646 (Bankr. E.D. Mich. 1985); *In re Keydata Corp.*, 37 Bankr. 324, 328 (Bankr. D. Mass. 1983); *In re Bishop*, 17 Bankr. 180, 183 (Bankr. N.D. Ga. 1982). The billback invoices, with the three exceptions noted above, do not indicate that the defendant transferred any value to the estate after an earlier preference, and accordingly defendant is not entitled to assert a defense for those billback invoices under § 547(c)(4).

Three invoices in the total amount of $6,862.66 evidence shipments on July 15, 1988. The first transfer, check number 209382 in the amount of $75,765.67, was mailed on or after July 15, 1988, and was paid by Mid-South Bank and Trust Company on July 19, 1988. In *Johnson v. Barnhill*, ___ U.S. ___, 112 S.Ct. 1386, 26 C.B.C.2d 323 (1992), the Supreme Court ruled that for purposes of § 547(b), a transfer by check is accomplished when the check clears the bank, which in this case was July 19, 1988, four days after July 15, 1988, the date of the shipments. Even if the operate transfer date is the date of receipt, defendant could not have possibly received on July 15 a check placed in the mail July 15, and the three July 15, 1988, shipments do not constitute new value given *after* a preferential transfer as required under § 547(c)(4). Accordingly, defendant is entitled to assert a defense under § 547(c)(4) in the limited amount of $29,431.60.

## Conclusion

The undisputed facts of this case, when viewed in a light most favorable to defendant, establish that plaintiffs' complaint is not time-barred under § 546(a), that every element of § 547(b) has been met, that § 547(c)(2) is wholly inapplicable to this case, and that § 547(c)(4) is applicable to the limited extent of $29,431.60. For good cause shown, it is, therefore

It is hereby **ORDERED** that:

1. The Motion for Summary Judgment or Partial Summary Judgment filed by Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors, be, and is hereby allowed, such that summary judgment shall be entered in favor of the plaintiffs in the amount of $543,038.92 ($572,470.52 transferred less new value of $29,431.60);

2. The Motion for Summary Judgment filed by Maurice Sporting Goods, Inc., be, and is hereby allowed in part and denied in part, such that the final summary judgment to be entered in the amount of $543,038.92 reflects defendant's new value defense in the amount of $29,431.60; and

3. A separate final summary judgment will be entered in accordance with the foregoing.

This the 26th day of January, 1993.

/s/ George R. Hodges
George R. Hodges
United States
Bankruptcy Judge

**IN THE UNITED STATES BANKRUPTCY COURT**
**UNITED STATES BANKRUPTCY COURT**
**WESTERN DISTRICT OF NORTH CAROLINA**

| | |
|---|---|
| **In Re:**<br>**MAXWAY CORPORATION, DANNERS, INC.,**<br>Debtors. | Case No. C-B-88-01027<br>Case No. C-B-88-01028<br>Chapter 11 |
| MAXWAY CORPORATION AND DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,<br>Plaintiffs,<br>v.<br>**MAURICE SPORTING GOODS, INC.**<br>Defendant. | Adversary Proceeding No. 91-3321<br>Judgment entered on 1-26-93. |

## FINAL SUMMARY JUDGMENT

(Filed Jan. 26, 1993)

THIS CAUSE came on for consideration before the undersigned United States Bankruptcy Judge upon cross motions for summary judgment. For the reasons set forth in a separate Order of even date,

It is hereby **ORDERED** that judgment is entered in favor of plaintiffs in the amount of $543,038.92, plus interest at the federal rate of 3.67% from date of judgment, and all costs.

This the 26th day of January, 1993.

/s/ George R. Hodges
George R. Hodges
United States
Bankruptcy Judge

FILE COPY

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 93-2552
CA-93-39-P
BK-88-1027-C-B
BK-88-1026-C-B

In re: MAXWAY CORPORATION; In re: DANNERS, INCORPORATED

Debtors

---

MAURICE SPORTING GOODS, INCORPORATED

Plaintiff - Appellant

v.

MAXWAY CORPORATION, by and through their Official Committee of Unsecured Creditors; DANNERS, INCORPORATED, by and through their Official Committee of Unsecured Creditors

Defendants - Appellees

---

On Petition for Rehearing with Suggestion for Rehearing In Banc

---

(Filed July 26, 1994)

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

**IT IS ORDERED** that the petition for rehearing and suggestion for rehearing in banc are denied.

For the Court,

/s/ Bert M. Montague
CLERK

**11 USC § 546. Limitations on avoiding powers**

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of –

(1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202 of this title; or

(2) the time the case is closed or dismissed.

(b) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection. If such law requires seizure of such property or commencement of an action to accomplish such perfection, and such property has not been seized or such action has not been commenced before the date of the filing of the petition, such interest in such property shall be perfected by notice within the time fixed by such law for such seizure or commencement.

(c) Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but –

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court –

(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or

(B) secures such claim by a lien.

(d) In the case of a seller who is a producer of grain sold to a grain storage facility, owned or operated by the debtor, in the ordinary course of such seller's business (as such terms are defined in section 557 of this title) or in the case of a United States fisherman who has caught fish sold to a fish processing facility owned or operated by the debtor in the ordinary course of such fisherman's business, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common law right of such producer or fisherman to reclaim such grain or fish if the debtor has received such grain or fish while insolvent, but –

(1) such producer or fisherman may not reclaim any grain or fish unless such producer or fisherman demands, in writing, reclamation of such grain or fish before ten days after receipt thereof by the debtor; and

(2) the court may deny reclamation to such a producer or fisherman with a right of reclamation that has made such a demand only if the court secures such claim by a lien.

(e) Notwithstanding sections 544, 545, 547, 548(a)(2) and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101(34), 741(5), or 761(15) of this title, or settlement payment, as

defined in section 101(35) or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

(f) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, made by or to a repo participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1) of this title.

(g) Notwithstanding sections 544, 545, 547, 548(a)(2) and 548(b) of this title, the trustee may not avoid a transfer under a swap agreement, made by or to a swap participant, in connection with a swap agreement and that is made before the commencement of the case, except under section 548(a)(1) of this title.

**11 USC § 547. Preferences**

(a) In this section –

(1) "inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;

(2) "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;

(3) "receivable" means right to payment, whether or not such right has been earned by performance; and

(4) a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer –

(1) to the extent that such transfer was –

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was –

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor –

(A) to the extent such security interest secures new value that was –

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 10 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor –

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of –

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title; or

(7) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.

(d) The trustee may avoid a transfer of an interest in property of the debtor transferred to or for the benefit of a surety to secure reimbursement of such a surety that furnished a bond or other obligation to dissolve a judicial lien that would have been avoidable by the trustee under subsection (b) of this section. The liability of such surety under such bond or obligation shall be discharged to the

extent of the value of such property recovered by the trustee or the amount paid to the trustee.

(e)(1) For the purposes of this section –

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made –

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of –

(i) the commencement of the case; or
(ii) 10 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

(g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

## SUBCHAPTER I – OFFICERS AND ADMINISTRATION

### 11 USC § 1101. Definitions for this chapter

In this chapter –

(1) "debtor in possession" means debtor except when a person that has qualified under section 322 of this title is serving as trustee in the case;

(2) "substantial consummation" means –

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;

(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

**11 USC § 1107. Rights, powers, and duties of debtor in possession**

(a) Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a) (2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

(b) Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case.

Supreme Court, U.S.
FILED
NOV 4 1994
OFFICE OF THE CLERK

No. 94-632

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1994

MAURICE SPORTING GOODS, INC.,
*Petitioner,*

v.

MAXWAY CORPORATION AND DANNERS, INC.,
by and through their OFFICIAL COMMITTEE
OF UNSECURED CREDITORS,
*Respondents.*

**On Petition For A Writ Of Certiorari To The United States Court of Appeals For the Fourth Circuit**

## RESPONDENTS' BRIEF IN OPPOSITION

REBECCA S. HENDERSON
PETREE STOCKTON, L.L.P.
3500 One First Union Center
Charlotte, NC 28202-6001
(704) 338-5000

*Counsel for Respondents*

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. 1-800-347-8208

BEST AVAILABLE COPY

17 pp

## QUESTION PRESENTED

Section 546(a) of the Bankruptcy Code, prior to its recent amendment, provided that an avoidance action "may not be commenced after the earlier of - (1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302 or 1202 of this title; or (2) the time the case is closed or dismissed." 11 U.S.C. §546(a) (amended 1994). The question presented is whether the two year period of §546(a)(1) is applicable to a debtor in possession, whose powers arise under §1107 of the Bankruptcy Code and who is not a trustee appointed under any of the subsections enumerated in §546(a)(1).

## LIST OF PARTIES

The parties to the proceedings below were Petitioner Maurice Sporting Goods, Inc., and Respondents Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors.

Maxway Corporation and Danners, Inc. are debtors in possession in bankruptcy cases pending in the United States Bankruptcy Court for the Western District of North Carolina. Prior to filing bankruptcy, Maxway Corporation was a North Carolina corporation, the stock of which was wholly-owned by Maxway Holdings, Inc., a privately held corporation. Prior to its bankruptcy Danners, Inc. was an Indiana corporation, the stock of which was wholly-owned by Maxway Corporation. Neither Maxway Corporation or Danners, Inc. have any subsidiaries other than wholly-owned subsidiaries.

## TABLE OF CONTENTS

QUESTION PRESENTED ..... i

LIST OF PARTIES ..... ii

TABLE OF AUTHORITIES ..... iv

DECISION BELOW ..... 1

REASONS FOR DENYING THE PETITION ..... 2

I. THE BANKRUPTCY REFORM ACT OF 1994 SUBSTANTIVELY AMENDED §546(a) OF THE BANKRUPTCY CODE, AND THIS AMENDMENT OBVIATES THE NEED TO RESOLVE THE CONFLICT IN THE CIRCUIT COURTS OF APPEAL ..... 2

II. A SPLIT IN THE CIRCUIT COURTS OF APPEAL OF THE INTERPRETATION OF OLD §546(a) IS TOLERABLE ..... 6

III. THE FOURTH CIRCUIT COURT OF APPEALS CORRECTLY INTERPRETED OLD §546(a) OF THE BANKRUPTCY CODE .. 7

CONCLUSION ..... 9

## TABLE OF AUTHORITIES

SUPREME COURT DECISIONS

*Reiter v. Sonotone Corporation*, 442 U.S. 330, 99 S.Ct. 2326, 60 L.Ed.2d 931 (1979) . . . . . 8

*U.S. v. Menasche*, 348 U.S. 528, 75 S.Ct. 513, 99 L.Ed. 615 (1955) . . . . . 9

*U.S. v. Nordic Village, Inc.*, ___ U.S. ___, 112 S. Ct. 1011, 117 L.Ed.2d 181 (1992) . . . . . 8

COURTS OF APPEAL DECISIONS

*Construction Mgt. Servs., Inc. v. Manufacturers Hanover Trust Co. (In re Coastal Group, Inc.)*, 13 F. 3d 81 (3d Cir. 1994) . . . . . 2

*In re Maxway Corporation*, 27 F.3d 980 (4th Cir. 1994) . . . . . 2, 4, 7

*In re McLean Industries, Inc.*, 30 F.3d 385 (2d Cir 1994) . . . . . 2

*U.S. Brass & Copper Co. v. Caplan (In re Century Brass Prods. Inc.)*, 22 F.3d 37 (2d Cir. 1994) . . . . . 2

*Upgrade Corp. v. Government Tech. Servs., Inc. (In re Softwaire Centre Int'l, Inc.)*, 994 F.2d 682 (9th Cir. 1993) . . . . . 2

*Zilkha v. Leighton*, 920 F.2d 1520 (10th Cir. 1990) . . . . . 2, 6

BANKRUPTCY COURT AND DISTRICT COURT DECISIONS

*In re Afco Development Corp.*, 65 B.R. 781 (Bankr. D. Utah 1986) . . . . . 3

*In re Air One, Inc.*, 75 B.R. 998 (Bankr. E.D. Mo. 1987) . . . . . 3

*In re Alithochrome Corp.*, 53 B.R. 906 (Bankr. S.D.N.Y. 1985) . . . . . 3

*In re Allegheny International, Inc.*, 136 B.R. 396 (Bankr. W.D. Pa. 1991), *aff'd* 145 B.R. 823 (W.D. Pa. 1992) . 3

*In re Brin-Mont Chemicals, Inc.*, 154 B.R. 903 (M.D.N.C. 1993) . . . . . 3

*In re Cardullo*, 142 B.R. 138 (Bankr. E.D. Va. 1992) . 3

*In re Denver/Robins Venture Partners, Ltd.*, 166 B.R. 769 (Bankr. M.D. Ga. 1994) . . . . . 3

*In re Electrical Materials Co.*, 160 B.R. 1018 (Bankr. W.D. Mo. 1993) . . . . . 3

*In re Hooker Investments, Inc.*, 162 B.R. 426 (Bankr. S.D.N.Y. 1993) . . . . . 3

*In re Hunt*, 136 B.R. 437 (Bankr. N.D.Tex. 1991) . . . 3

*In re J.E. Jennings, Inc.*, 46 B.R. 167 (Bankr. E.D. Pa. 1985) . . . . . 4

*In re Jet Florida System, Inc.*, 73 B.R. 552 (Bankr. S.D. Fla. 1987) . . . . . 3

*In re Korvettes, Inc.*, 67 B.R. 730 (S.D.N.Y. 1986) . . . 3

*In re Mahoney, Trocki & Assoc., Inc.*, 111 B.R. 914 (Bankr. S.D. Cal. 1990) . . . . . 3

*In re Mars Stores, Inc.*, 150 B.R. 869 (Bankr. D. Mass. 1993) . . . . . 3

*In re Matter of Choice Vend, Inc.*, 49 B.R. 719 (Bankr. D. Conn. 1985) . . . . . 4

*In re National Steel Service Center, Inc.*, 170 B.R. 745 (Bankr. N.D. Ga. 1994) . . . . . 3

*In re One Marketing Co., Inc.*, 17 B.R. 738 (Bankr. S.D. Tex. 1982) . . . . . 4

*In re Pullman Construction Industries, Inc.*, 132 B.R. 359 (Bankr. N.D. Ill. 1991) . . . . . 3

*In re Steel*, Inc., 55 B.R. 426 (Bankr. E.D. La. 1985) . . . . . 4

*In re Tamiami Range and Gun Shop, Inc.*, 130 B.R. 617 (Bankr. S.D. Fla. 1991) . . . . . 3

*In the Matter of Silver Mills Frozen Foods, Inc.*, 23 B.R. 179 (Bankr. W.D. Mich. 1982) . . . . . 4

*Matter of Freedom Ford, Inc.*, 140 B.R. 585 (Bankr. M.D. Fla. 1992) . . . . . 3

STATUTES AND RULES

11 U.S.C. §546 (1994) . . . . . 4, 5

11 U.S.C. §546(a)(amended 1994) . . . . . 2-9

Bankruptcy Reform Act of 1994 . . . . . 2, 4, 6

OTHER AUTHORITIES

4 COLLIER BANKRUPTCY PRACTICE GUIDE ¶64.02[6] (1993) . . . . . 4

4 COLLIER ON BANKRUPTCY ¶546.02[2] [15th ed. 1990) . . . . . 4

No. 94-632

---

In The

**Supreme Court of the United States**

October Term, 1994

MAURICE SPORTING GOODS, INC.,

Petitioner,

v.

MAXWAY CORPORATION AND DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS

Respondents.

---

**On Petition For A Writ of Certiorari To The United States Court of Appeals For the Fourth Circuit**

---

# RESPONDENTS' BRIEF IN OPPOSITION

---

Respondents Maxway Corporation and Danners, Inc., by and through their Official Committee of Unsecured Creditors, respectfully request that the Court deny the petition for a writ of certiorari seeking review of the opinion of the Court of Appeals for the Fourth Circuit reported at 27 F.3d 980 (4th Cir. 1994).

## REASONS FOR DENYING THE PETITION

### I. The Bankruptcy Reform Act of 1994 substantively amended §546(a) of the Bankruptcy Code, and this amendment obviates the need to resolve the conflict in the Circuit Courts of Appeal.

The Respondents acknowledge that the decision of the Fourth Circuit Court of Appeals reported at 27 F.3d 980 (4th Cir. 1994), *In re Maxway Corporation*, conflicts with decisions of the Second, Third, Ninth and Tenth Circuit Courts of Appeal;[1] however, because of the enactment on October 22, 1994, of the Bankruptcy Reform Act of 1994 (the "1994 Reform Act"), resolution of this conflict by this Court would be merely academic.

Prior to its amendment by §216 of the 1994 Reform Act, §546(a) of the Bankruptcy Code provided as follows:

> An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of -

---

[1] *In re McLean Industries, Inc.*, 30 F.3d 385 (2d Cir 1994); *U.S. Brass & Copper Co. v. Caplan (In re Century Brass Prods. Inc.)*, 22 F.3d 37 (2d Cir. 1994); *Construction Mgt. Servs., Inc. v. Manufacturers Hanover Trust Co. (In re Coastal Group, Inc.)*, 13 F. 3d 81 (3d Cir. 1994); *Upgrade Corp. v. Government Tech. Servs., Inc. (In re Softwaire Centre Int'l, Inc.)*, 994 F.2d 682 (9th Cir. 1993); *Zilkha v. Leighton*, 920 F.2d 1520 (10th Cir. 1990).

> (1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302 or 1202 of this title; or
>
> (2) the time the case is closed or dismissed.

11 U.S.C. §546(a)(amended 1994).

The great majority of bankruptcy courts, district courts, and bankruptcy practitioners have interpreted Bankruptcy Code §546(a) in accordance with its plain language and determined that in a chapter 11 case, all avoidance actions must be filed within two years after the appointment of a trustee under Bankruptcy Code §1104, or if no trustee had been appointed under §1104, by the time the case was closed or dismissed.[2] The Fourth

---

[2] *See, e.g., In re National Steel Service Center, Inc.*, 170 B.R. 745 (Bankr. N.D. Ga. 1994); *In re Denver/Robins Venture Partners, Ltd.*, 166 B.R. 769 (Bankr. M.D. Ga. 1994); *In re Hooker Investments, Inc.*, 162 B.R. 426 (Bankr. S.D.N.Y. 1993); *In re Electrical Materials Co.*, 160 B.R. 1018 (Bankr. W.D. Mo. 1993); *In re Brin-Mont Chemicals, Inc.*, 154 B.R. 903 (M.D.N.C. 1993); *In re Mars Stores, Inc.*, 150 B.R. 869 (Bankr. D. Mass. 1993); *In re Allegheny International, Inc.*, 136 B.R. 396 (Bankr. W.D. Pa. 1991), *aff'd* 145 B.R. 823 (W.D. Pa. 1992); *In re Cardullo*, 142 B.R. 138 (Bankr. E.D. Va. 1992); *Matter of Freedom Ford, Inc.*, 140 B.R. 585 (Bankr. M.D. Fla. 1992); *In re Hunt*, 136 B.R. 437 (Bankr. N.D.Tex. 1991); *In re Pullman Construction Industries, Inc.*, 132 B.R. 359 (Bankr. N.D. Ill. 1991); *In re Tamiami Range and Gun Shop, Inc.*, 130 B.R. 617 (Bankr. S.D. Fla. 1991); *In re Mahoney, Trocki & Assoc., Inc.*, 111 B.R. 914 (Bankr. S.D. Cal. 1990); *In re Air One, Inc.*, 75 B.R. 998 (Bankr. E.D. Mo. 1987); *In re Jet Florida System, Inc.*, 73 B.R. 552 (Bankr. S.D. Fla. 1987); *In re Korvettes, Inc.*, 67 B.R. 730 (S.D.N.Y. 1986); *In re Afco Development Corp.*, 65 B.R. 781 (Bankr. D. Utah 1986); *In re Alithochrome Corp.*,

(continued...)

Circuit Court of Appeals also embraced this strict construction and found that the two year statute of limitations does not begin to run until the appointment of one of the trustees specified in Bankruptcy Code §546(a)(1).[3]

The Second, Third, Ninth and Tenth Circuits, however, abandoned the traditional rules of statutory construction and found that notwithstanding the plain language of Bankruptcy Code §546(a)(1), it applies to debtors in possession, who are not trustees appointed under any of the sections enumerated in §546(a)(1), and that the time begins to run against a debtor in possession upon the filing of the bankruptcy petition.

Congress has remedied the Circuit Courts' inconsistent interpretations of §546(a)(1) in §216 of the 1994 Reform Act. As amended by the 1994 Reform Act, Bankruptcy Code §546(a) now provides the following:

> An action or proceeding under section 544, 545, 547, 548, or 553 of this

---

[2](...continued)
53 B.R. 906 (Bankr. S.D.N.Y. 1985); *In re Matter of Choice Vend, Inc.*, 49 B.R. 719 (Bankr. D. Conn. 1985); *In re J.E. Jennings, Inc.*, 46 B.R. 167 (Bankr. E.D. Pa. 1985); *In re Steel, Inc.*, 55 B.R. 426 (Bankr. E.D. La. 1985); *In the Matter of Silver Mills Frozen Foods, Inc.*, 23 B.R. 179 (Bankr. W.D. Mich. 1982); *In re One Marketing Co.*, Inc., 17 B.R. 738 (Bankr. S.D. Tex. 1982); 4 COLLIER ON BANKRUPTCY ¶546.02[2] [15th ed. 1990); 4 COLLIER BANKRUPTCY PRACTICE GUIDE ¶64.02[6] (1993).

[3] *Maxway*, at 984.

> title may not be commenced after the earlier of -
>
> (1) the later of -
>
> (A) 2 years after the entry of the order for relief; or
>
> (B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or
>
> (2) the time the case is closed or dismissed.

11 U.S.C. §546 (1994).

Through this amendment, Congress has substantively changed §546(a)(1) and definitively established an outside limit for bringing avoidance actions, applicable to all parties. Now, in a chapter 11 case, as long as the debtor remains in possession, actions must be commenced within two years. Trustees under all chapters appointed within the initial two year period are subject to this same deadline, except that the time may be extended to allow trustees at least a year after appointment to commence actions.

The amendment renders all of the Circuit Courts' interpretations of old §546(a)(1) irrelevant. This Court therefore does not need to resolve the conflict.

## II. A split in the Circuit Courts of Appeal of the interpretation of old §546(a) is tolerable.

Although the 1994 Reform Act is effective upon enactment,[4] it generally does not apply to pending cases. Respondents acknowledge that there are cases, such as the Respondents' bankruptcy cases, which will be governed by the existing, and conflicting, interpretations of §546(a)(1). The number of these cases, however, is statistically insignificant, and a conflict affecting such a small number of cases, decreasing with time, is permissible.

After the Tenth Circuit Court of Appeals decision of *Zilkha v. Leighton* in 1990,[5] the first circuit court to decide that §546(a)(1) applied to debtors in possession, bankruptcy practitioners have advised debtors in possession to file avoidance actions within two years of the entry of the order for relief.[6] Practically speaking then, the conflict in the Circuit Courts of Appeal affects only that number of chapter 11 cases which were filed more than two years before the December 1990 *Zilkha* decision and in which the debtors are still in possession.

---

[4] Bankruptcy Reform Act of 1994, §702.

[5] 920 F.2d 1520 (10th Cir. 1990).

[6] The Respondents' bankruptcy cases had been pending more than two years when *Zilkha* was decided.

The Administrative Office of the United States Courts reports that of the 1,156,310 bankruptcy cases pending as of December 31, 1993, only two percent (2%) are chapter 11 cases filed before January 1, 1990.[7] Given the statistically small number of cases affected by this issue, the conflict is tolerable.

## III. The Fourth Circuit Court of Appeals correctly interpreted old §546(a) of the Bankruptcy Code.

The Fourth Circuit Court of Appeals' interpretation of old §546(a)(1) follows the traditional rules of statutory construction, is correct, and should not be disturbed. The Fourth Circuit stated that "courts should venture beyond the plain meaning of the statute only in those rare instances in which there is a clearly expressed legislative intent to the contrary, in which a literal application of the statute would thwart its obvious purpose, or in which a literal application of the statute would produce an absurd result."[8] Since none of those circumstances are present in this case, the Fourth Circuit found that §546(a)(1) is not applicable to a debtor in possession.

In its petition to this Court for a writ of certiorari, Petitioner strains to argue ambiguity in §546(a)(1) by

---

[7] Chapter 11 debtors in possession in cases filed after January 1, 1990, will have had at least one full year after the *Zilkha* decision within which to bring avoidance actions.

[8] *Maxway*, at 982-83 (citations omitted).

focusing on the use of the word *appointment.* Petitioner artfully encourages an expansive definition of *appointment* to include any designation of a permanent representative of the estate, including a debtor in possession that assumes duties under Bankruptcy Code §§1101(1) and 1107(a). Petitioner's argument fails, however, because it ignores the words that modify and limit the term *appointment.* It is not merely the appointment of a trustee or its equivalent, but the appointment of a trustee *under section 702, 1104, 1163, 1302 or 1202*. Section 1107, the section through which a debtor in possession derives its rights, powers and duties, is not included in that list. Had Congress concluded §546(a)(1) with the phrase "and not a debtor in possession under section 1107", Congressional intent may have been slightly more apparent, but the omission of that phrase does not make the statute ambiguous.

Moreover, §546(a)(1) is the only Bankruptcy Code section empowering or limiting a trustee which also specifically identifies the Bankruptcy Code sections under which the trustee appointment is made.[9] If §546(a)(1) applies to debtors in possession, the phrase "under section 702, 1104, 1163, 1302 or 1202" would be inoperative and wholly superfluous.[10] Modification of the word *trustee*

---

[9] There are at least seventeen other places in the Bankruptcy Code where a trustee is empowered or limited.

[10] *See U.S. v. Nordic Village, Inc.*, ___ U.S. ___, 112 S. Ct. 1011, 117 L.Ed.2d 181 (1992)(a statute must, if possible, be construed in such fashion that every word has some operative effect); *See also Reiter v.*

(continued...)

with the specific appointment provisions was not an accident, and the only way to give those words any effect is to determine that Congress used them in order to exclude debtors in possession from the two year bar.

The Fourth Circuit reached the correct result in its interpretation of §546(a)(1), and the soundness of its decision argues against review by this Court.

**Conclusion**

For the reasons set forth herein, Respondents request that the petition for writ of certiorari be denied.

This the 4th day of November, 1994.

Respectfully submitted,

REBECCA S. HENDERSON
PETREE STOCKTON, L.L.P.
3500 One First Union Center
Charlotte, North Carolina
28202-6001
Telephone: (704) 338-5000
Telecopy: (704) 338-5125
Counsel for Respondents

---

[10](...continued)
*Sonotone Corporation*, 442 U.S. 330, 99 S.Ct. 2326, 60 L.Ed.2d 931 (1979); *U.S. v. Menasche*, 348 U.S. 528, 75 S.Ct. 513, 99 L.Ed. 615 (1955).

Supreme Court, U.S.
FILED
NOV 18 1994
OFFICE OF THE CLERK

No. 94-632

In The

# Supreme Court of the United States

October Term, 1994

MAURICE SPORTING GOODS, INC.,

*Petitioner,*

v.

MAXWAY CORPORATION and DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,

*Respondents.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit**

## PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JOHN HENDERSON HASTY
Counsel of Record

KIRBY TODD PHILLIPS
WAGGONER, HAMRICK, HASTY, MONTEITH & KRATT
Suite 2500 Two First Union Center
Charlotte, North Carolina 28282
Telephone: (704) 332-6141
Telecopier: (704) 375-5102

*Attorneys for Petitioner*

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

## QUESTION PRESENTED

11 U.S.C. §546(a), as applied by the court below, provides that preference actions under §547 of the Bankruptcy Code must be brought within two years of the appointment of a trustee under the Bankruptcy Code; 11 U.S.C. §1107(a) provides that a Chapter 11 debtor-in-possession is "[s]ubject to any limitations on a trustee serving in a case under this chapter". The issue presented is whether a debtor-in-possession, acting as a trustee under §1107(a), is subject to the two-year statute of limitations imposed by §546(a)(1), or, irrespective of the plain language of §1107(a), that a debtor-in-possession is free to bring preference actions at any time until the case is closed or dismissed, which may be five, ten, twenty, or even more years after the commencement of the bankruptcy case.

## LIST OF PARTIES

The parties to the proceedings below were the Petitioner, Maurice Sporting Goods, Inc., and the Respondents, Maxway Corporation and Danners, Inc., acting by and through their Official Committee of Unsecured Creditors.

Maurice Sporting Goods, Inc. ("Maurice") is a corporation organized under the laws of the state of Illinois. Maurice is 100% privately held. Maurice has no subsidiaries, other than one wholly-owned subsidiary.

TABLE OF CONTENTS

Page

QUESTION PRESENTED ..... i

LIST OF PARTIES ..... ii

TABLE OF AUTHORITIES ..... iv

I. ENACTMENT OF THE BANKRUPTCY REFORM ACT OF 1994 HEIGHTENS AND SUPPORTS THE NEED FOR THE COURT TO GRANT CERTIORARI ..... 2

A. CONGRESS' CLARIFICATION OF CODE §546(a) MEANS THE CIRCUIT COURTS' CONSTRUCTIONS THEREOF ARE RELEVANT AND CONGRESS' CONSTRUCTION SHOULD BE GIVEN RETROACTIVE EFFECT ..... 2

B. IF CONGRESS' CLARIFICATION OF §546(a) IS NOT RETROACTIVELY APPLIED, THE ISSUE WILL CONTINUE TO EXIST FOR DECADES AND THE NEED FOR CERTIORARI TO RESOLVE THE CONFLICTING CIRCUIT DECISIONS CONTINUES ..... 5

C. A SPLIT AMONG THE CIRCUITS IS INTOLERABLE AND WILL ONLY LEAD TO GREATER LITIGATION AND CONFUSION .. 7

II. IN LIGHT OF CONGRESS' CLARIFICATION, THE GRANT OF CERTIORARI AND SUMMARY REVERSAL OF THE FOURTH CIRCUIT IS APPROPRIATE ..... 8

CONCLUSION ..... 9

APPENDIX ..... App.-1

# TABLE OF AUTHORITIES

Page

SUPREME COURT DECISIONS

*Bureau of Economic Analysis v. Long*, 454 U.S. 980, 102 S.Ct. 468, 70 L.Ed.2d 242 (1980) ..... 9

*Red Lion Broadcasting Co. v. F.C.C.*, 395 U.S. 367, 89 S.Ct. 1794, 23 L.Ed.2d 371 (1969) ..... 3

*Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 100 S.Ct. 800, 63 L.Ed.2d 36 (1980) ..... 3

*Union Bank v. Wolas*, 502 U.S. ___, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991) ..... 5

COURTS OF APPEAL DECISIONS

*In re Adams*, 761 F.2d 1422 (9th Cir. 1985) ..... 3, 6

*In re Fielder*, 799 F.2d 656 (11th Cir. 1986) ..... 3

*May Department Stores Co. v. Smith*, 572 F.2d 1275 (8th Cir.), *cert. denied*, 439 U.S. 837, 99 S.Ct. 122, 58 L.Ed.2d 134 (1978) ..... 3

*United States v. State of Michigan*, 623 F.2d 448 (6th Cir. 1980), *modified on other grounds*, 653 F.2d 277, 281, *cert. denied*, 454 U.S. 1124, 102 S.Ct. 971, 71 L.Ed.2d 110, *on remand*, 520 F.Supp. 207 (W.D. Mich. 1981) ..... 9

BANKRUPTCY COURT AND DISTRICT COURT DECISIONS

*Field v. Maryland Federal Savings and Loan Association (In re Anton Motors, Inc.)*, Adversary No. 94-1408 (Bankr. D. Md. Oct. 27, 1994) ..... 6

*In re Excel Enterprises, Inc.*, 83 B.R. 427 (Bankr. W.D. La. 1988) ..... 5

*In re Lill*, 116 B.R. 543 (Bankr. N.D. Ohio 1990) ..... 7

TABLE OF AUTHORITIES – Continued

Page

STATUTES AND RULES

11 U.S.C. §301 ..... 5

11 U.S.C. §546(a) ..... 2, 3, 4, 5, 6, 7, 8, 9

11 U.S.C. §547 ..... 2, 5

28 U.S.C. §2106 ..... 8

Supreme Court Rule 16.1 ..... 8

Bankruptcy Rule 7001 ..... 5

OTHER AUTHORITIES

Bankruptcy Amendments and Federal Judgeship Act of 1984, P.L. 98-353, 98 Stat. 392 ..... 4

Bankruptcy Reform Act of 1994, H.R. 5116, P.L. 103-394 ..... 2, 3, 5, 6, 8, 9

130 Cong.Rec. (daily ed. June 29, 1984) (statements of Rep. Rodino), *reprinted in* 1984 U.S. Code Cong. & Ad. News 576 ..... 4

H. Rep. 103-835, to accompany H.R. 5116, 140 Cong.Rec. (daily edition, October 4, 1994), H. 10764 ..... 2, 5

104 Cong.Rec. (daily edition October 6, 1994), S. 14461 ..... 3

No. 94-632

In The

# Supreme Court of the United States

October Term, 1994

MAURICE SPORTING GOODS, INC.,

*Petitioner,*

v.

MAXWAY CORPORATION and DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,

*Respondents.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit**

## PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Maurice Sporting Goods, Inc., the Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-entitled proceeding on June 23, 1994.

## I. ENACTMENT OF THE BANKRUPTCY REFORM ACT OF 1994 HEIGHTENS AND SUPPORTS THE NEED FOR THE COURT TO GRANT CERTIORARI.

### A. CONGRESS' CLARIFICATION OF CODE §546(a) MEANS THE CIRCUIT COURTS' CONSTRUCTIONS THEREOF ARE RELEVANT AND CONGRESS' CONSTRUCTION SHOULD BE GIVEN RETROACTIVE EFFECT.

A bankruptcy trustee's power to recover a preference under Code §547 is subject to Code §546(a)'s statute of limitations. Maurice contends that a debtor-in-possession, acting as a trustee in bringing an avoidance action, is subject to the statute of limitations. At the time this action was commenced, the version of Code §546(a) in effect ("Original §546(a)"), which is set forth in the Appendix at App.-1, was ambiguous. Original §546(a) was still in effect when the Fourth Circuit rendered its decision which is directly contrary to the decisions of the Second, Third, Ninth, and Tenth Circuits.

Maurice filed its Petition for Certiorari on October 6, 1994. On October 22, 1994, the President signed the Bankruptcy Reform Act of 1994, H.R. 5116, P.L. 103-394. Section 216 of P.L. 103-394, which is set forth in the Appendix at App.-2, clarifies Code §546(a) ("Clarified §546(a)(1)") to remove the ambiguity at issue here. P.L. 103-394's legislative history includes the House Judiciary Committee's report, which contains a section-by-section analysis of the bill. The report, relevant portions of which are reproduced in the Appendix at App.-3, unequivocally demonstrates that Congress intended to clarify the law and Congress always intended for the two-year limitation to apply to a debtor-in-possession. H. Rep. 103-835, to accompany H.R. 5116, 140 Cong.Rec. 142 (daily edition, October 4, 1994), H. 10764, 10768.

Similarly, the legislative history in the Senate, relevant portions of which are reproduced in the Appendix at App.-4, demonstrates even more strongly that Congress intended to clarify the law and always intended for the two-year statute of limitations to apply to a debtor-in-possession. 104 Cong.Rec. 144 (daily edition October 6, 1994), S. 14461, 14465.

"Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction." *Red Lion Broadcasting Co. v. F.C.C.*, 395 U.S. 367, 380-381, 89 S.Ct. 1794, 1802, 23 L.Ed.2d 371, 383 (1969); *also see Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 596, 100 S.Ct. 800, 814, 63 L.Ed.2d 36, 54 (1980).

When P.L. 103-394 was enacted, there was a clear conflict at all levels of the federal court system over the construction of Code §546(a)(1). A conflict among the courts indicates that a subsequent amendment clarifies, rather than changes, the existing law. *See In re Fielder*, 799 F.2d 656, 660 (11th Cir. 1986) (*per curiam*); *May Department Stores Co. v. Smith*, 572 F.2d 1275, 1278 (8th Cir.) (*per curiam*), *cert. denied*, 439 U.S. 837, 99 S.Ct. 122, 58 L.Ed.2d 134 (1978).

A clarification of the law is to be applied retroactively to the construction of the original statute. *In re Adams*, 761 F.2d 1422, 1427 (9th Cir. 1985). In *Adams*, the debtor drove his vehicle while legally intoxicated, striking Betty Moraes' vehicle and injuring her. Moraes filed an adversary proceeding, contending that Adams was liable for her injuries. At this time, courts were divided whether driving while intoxicated, without more, constituted conduct sufficiently willful and malicious to warrant a finding of non-dischargeability under Code §523(a)(6).

On July 10, 1984, two months *after* the entry of judgment in favor of Moraes, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"), P.L. 98-353, 98 Stat. 392. BAFJA §371 added Code §523(a)(9), which specifically excepted from discharge a claim arising from a debtor's operation of a motor vehicle while legally intoxicated. However, pursuant to §553(a) thereof, BAFJA was "effective to cases filed 90 days after the date of enactment."

In §523(a)(9)'s legislative history, Congress recognized the conflict and stated that the amendment was intended to clarify the law. 130 Cong.Rec. (daily ed. June 29, 1984) (statements of Rep. Rodino), *reprinted in* 1984 U.S. Code Cong. & Ad. News 576, 577. Based upon the split among the courts and Congress' stated intent to clarify the Code, the Ninth Circuit held that the Congress' clarification applied retroactively to the construction of §523(a)(6) and affirmed the district court.

In this action, Debtors' first contention is that P.L. 103-394 renders the circuit courts' interpretation of Original §546(a)(1) irrelevant. To the contrary, by *clarifying* rather than substantively changing the law, Congress demonstrated that decisions of the Second, Third, Ninth, and Tenth Circuits are correct and their construction should be applied by all courts, including this Court, retroactively.

If Debtors' contention were to have any validity, it would be that the Fourth Circuit's decision has lost any significance since its reading of Original §546(a) has been rejected by Congress. However, even that statement would be incorrect. As discussed in Maurice's motion for a stay of execution, Debtors executed on the judgment of the courts below and currently hold $576,728.01 seized from Maurice. Thus the Fourth Circuit's decision retains

its importance to the parties until it is reversed and those funds are returned to Maurice. Moreover, as demonstrated below, it remains relevant to other parties inside and outside the Fourth Circuit.

### B. IF CONGRESS' CLARIFICATION OF §546(a) IS NOT RETROACTIVELY APPLIED, THE ISSUE WILL CONTINUE TO EXIST FOR DECADES AND THE NEED FOR CERTIORARI TO RESOLVE THE CONFLICTING CIRCUIT DECISIONS CONTINUES.

As set forth in the Appendix at App.-5, §702 of P.L. 103-394 provides that, with exceptions not relevant here, P.L. 103-394 applies to cases commenced after the date of enactment. H.R. 5116, §702, 103d Cong., 2d Sess., 140 Cong.Rec. (daily edition October 4, 1994), H. 10752, 10763.

The filing of a petition in bankruptcy commences a "case". *See* Code §301. By contrast, an avoidance action is not a "case" but, instead, is known as an "adversary proceeding", *see* Bankruptcy Rule 7001, and is commenced by filing a complaint. As illustrated in *In re Excel Enterprises, Inc.*, 83 B.R. 427, 430 (Bankr. W.D. La. 1988), the difference between "cases" and "adversary proceedings" is critical (holding that the law of an adversary proceeding is the law in effect on the date the underlying bankruptcy case was commenced).[1]

---

[1] As recognized by this Court in *Union Bank v. Wolas*, 502 U.S. ___, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991), amendment of Code §547(c)(2) (the amendment in question in *Excel*) was a *substantive* change in the law. By contrast, §216 of the 1994 Act merely clarifies existing law with respect to the applicability of the 2-year statute of limitations to a debtor-in-possession. Thus,

Under the Fourth Circuit's erroneous decision, the only limit on a debtor-in-possession's ability to bring an avoidance action is the close of the case, which may be 15 years or even longer after commencement of the case. If construction of Original §546(a) is not governed by §216 of P.L. 103-394, then it has no effect in any bankruptcy case commenced before October 22, 1994.[2] A single Chapter 11 case may spawn hundreds of adversary proceedings; the issue may arise in each adversary proceeding in any Chapter 11 case commenced prior to October 22, 1994 regardless of whether that adversary proceeding is commenced on October 21, 1994; October 23, 1994; or October 23, 2004.[3] In the Fourth Circuit, there will continue to be no limitation on a debtor-in-possession's ability to commence an avoidance action.[4] Moreover, in each circuit which has not addressed the issue, untold hours of judicial resources will be wasted litigating the construction of Original §546(a)(1) and the effect of P.L. 103-394. This

---

as demonstrated by *In re Adams, supra*, this section is not intended to suggest that §216 of the P.L. 103-394 does not apply retroactively to the construction of Original §546, but, instead, merely to identify the effect of a non-retroactive application.

[2] According to statistics compiled by the Administrative Office of the United States Courts, 71,637 cases filed under Chapter 11 were pending as of June 30, 1994.

[3] According to statistics compiled by the Administrative Office of the United States Courts, 120,603 adversary proceedings were pending as of June 30, 1994.

[4] *See* Transcript of the hearing in *Field v. Maryland Federal Savings and Loan Association (In re Anton Motors, Inc.)*, Adversary No. 94-1408 (Bankr. D. Md. Oct. 27, 1994), where the Honorable James Hill denied defendant's motion to dismiss the plaintiff's complaint as barred by Code §546(a)(1) and held that, notwithstanding enactment of P.L. 103-394, the decision herein controls in all Chapter 11 cases in the Fourth Circuit.

Court should grant certiorari to resolve the split among the circuits.

### C. A SPLIT AMONG THE CIRCUITS IS INTOLERABLE AND WILL ONLY LEAD TO GREATER LITIGATION AND CONFUSION.

Debtors' second contention that a split among the circuits in the interpretation of Original §546(a) is tolerable. In support thereof, Debtors contend that subsequent to the *Zilkha* decision in 1990, "bankruptcy practitioners have advised debtors-in-possession to file avoidance actions within two years of the entry of the order for relief. Practically speaking then, the conflict in the circuit courts of appeal affects only that number of Chapter 11 cases which were filed more than two years before the December 19, 1990 *Zilkha* decision and in which the debtors are still in possession." *Debtors' Brief*, p. 6.

Notwithstanding that it is wholly unsupported by the record, Debtors' contention is irrelevant and incorrect. To begin with, although *Zilkha* was the first decision by a circuit court, it was not the first published decision to recognize that a debtor-in-possession is subject to §546(a)(1). *See, e.g., In re Lill*, 116 B.R. 543, 546 (Bankr. N.D. Ohio 1990) (published prior to the running of the statute of limitations herein). Obviously, the existence of *Zilkha*-like authority did not deter Debtors.

Moreover, a review of the decisions cited by Debtors shows that, following *Zilkha*, either bankruptcy practitioners have failed to advise debtors-in-possession or that debtors-in-possession have ignored such advice, since debtors-in-possession keep bringing avoidance actions more than two years after the order for relief, thereby forcing the waste of countless hours of limited judicial resources addressing the issue and prejudicing creditors

and defendants alike by improperly extending the life of Chapter 11 cases. As Debtors reported in their brief, a majority of published bankruptcy court decisions have decided the issue contrary to Congress' intent; there is no reason to conclude that bankruptcy courts will do anything but continue to misconstrue Original §546(a) and encourage debtors-in-possession to perpetuate the waste of time and creditors' money.

In sum, it is abundantly clear that unless certiorari is granted, this issue will continue to arise. Countless hours and millions of dollars which could otherwise be distributed to creditors will be spent litigating the construction of Original §546(a) and the effect of Clarified §546(a). This result and a continued split among the circuits is intolerable in light of Congress' unmistakable dictates.

## II. IN LIGHT OF CONGRESS' CLARIFICATION, THE GRANT OF CERTIORARI AND SUMMARY REVERSAL OF THE FOURTH CIRCUIT IS APPROPRIATE.

As noted herein, a refusal by this Court to grant certiorari will leave an erroneous decision on the record which will continue to affect courts within and without the Fourth Circuit and will cause the further waste of judicial resources in other circuits and creditors' money. The Court can prevent such a waste of resources by granting certiorari and simultaneously reversing or vacating the decision of the Fourth Circuit pursuant to Supreme Court Rule 16.1 and 28 U.S.C. §2106. In light of Congress' clarification of §546(a), this Court can provide substantial guidance to the lower courts by granting certiorari and summarily reversing the Fourth Circuit's clearly erroneous decision.

Adoption of a new regulation has been recognized as an appropriate reason to exercise this power, *see United States v. State of Michigan*, 623 F.2d 448 (6th Cir. 1980), *modified on other grounds*, 653 F.2d 277, 281, *cert. denied*, 454 U.S. 1124, 102 S.Ct. 971, 71 L.Ed.2d 110, *on remand*, 520 F.Supp. 207 (W.D. Mich. 1981); use of such power is appropriate here, where Congress has merely clarified the law consistent with the construction of most of the circuits. Alternatively, the Court should order the Fourth Circuit to reconsider its decision herein in light of the subsequent clarification of the law by Congress. *See Bureau of Economic Analysis v. Long*, 454 U.S. 980, 102 S.Ct. 468, 70 L.Ed.2d 242 (1980).

By summarily reversing the Fourth Circuit, the Court will ensure that Original §546(a) is construed the same as Clarified §546(a) in Chapter 11 cases with respect to a debtor-in-possession. Thus, (1) as originally intended by Congress, the two-year statute of limitations will apply to a debtor-in-possession; (2) Congress' clarification will be given effect; (3) the rights of creditors and potential defendants will be the same, regardless of whether a Chapter 11 bankruptcy case is commenced before or after October 22, 1994; (4) judicial resources will be preserved by preventing further litigation; and (5) expeditious administration of Chapter 11 cases will be encouraged.

## CONCLUSION

For the reasons cited herein, Maurice Sporting Goods, Inc., Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-captioned case on June 23, 1994. In the event the petition is granted, Maurice prays that the judgment of

the United States Court of Appeals for the Fourth Circuit be reversed and that this action be remanded with instructions that this action be dismissed with prejudice.

Respectfully submitted this 17th day of November, 1994.

JOHN HENDERSON HASTY
COUNSEL OF RECORD

KIRBY TODD PHILLIPS
WAGGONER, HAMRICK, HASTY,
MONTEITH & KRATT
Suite 2500 Two First Union Center
Charlotte, North Carolina 28282
Telephone: (704) 332-6141
Telecopier: (704) 375-5102

*Attorneys for Petitioner*

An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of –

(1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202 of this title; or

(2) the time the case is closed or dismissed.

11 U.S.C. §546(a) (1978, as amended)

**SEC. 216. LIMITATION ON AVOIDING POWERS.**

Section 546(a)(1) of title 11, United States Code, is amended to read as follows:

"(1) the later of:

"(A) 2 years after the entry of the order for relief; or

"(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (1); or".

H.R. 5116, §216, 103d Cong., 2d Sess., 140 Cong.Rec. (daily edition October 4, 1994), H. 10752, 10757

Section 216. Limitation of avoiding powers

This section clarifies section 546(a)(1) of the Bankruptcy Code which imposes a 2-year statute of limitations within which an appointed trustee must bring an avoidance action. The purpose of the statute of limitations is to define the period of time that a party is at risk of suit. This section defines the applicable statute of limitations as 2 years from the entry of an order for relief or 1 year after the appointment of the first trustee if such appointment occurs before the expiration of the original 2-year period. This section is not intended to affect the validity of any tolling agreement or have any bearing on the equitable tolling doctrine where there has been fraud determined to have occurred. The time limits are not intended to be jurisdictional and can be extended by stipulation between the necessary parties to the action or proceeding.

H. Rep. 103-835, to accompany H.R. 5116, 140 Cong.Rec. 142 (daily edition, October 4, 1994), H. 10764, 10768

The House has added a new provision, section 216, to the Bankruptcy Reform Act and I would like to clarify my belief as to the purpose and intent of including this section. It is my understanding that the current statute of limitations contained in section 546(a) of title 11 requires an avoidance action be brought within 2 years of the filing of a chapter 11 petition, even if a trustee or other estate representative is subsequently appointed or the case is later converted. Thus, under current law, if a trustee or other estate representative is appointed after the current 2 year statute of limitations expires, any actions which the trustee may discover are time-barred. This amendment has arisen from the perceived need to provide a period of time for a later appointed bankruptcy estate representative to investigate and institute actions.

This is yet another area of bankruptcy law that has been the subject of extensive litigation recently, and I commend the Congress for its attention to this problem. This amendment should prevent prejudice against potential defendants that would result in having to defend stale actions and should encourage estate representatives to investigate and resolve actions earlier in a bankruptcy case, thus minimizing estate expenses and maximizing the value of the estate to all creditors.

104 Cong.Rec. 144 (daily edition October 6, 1994), S. 14461, 14465 (statements of Senator Hatch)

SEC. 702, EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE. Except as provided in subsection (b), this Act shall take effect on the date of enactment of this Act.

(b) APPLICATION OF AMENDMENTS. (1) Except as provided in paragraph (2), the amendments made by this Act shall not apply with respect to cases commenced under title 11 of the United States Code before the date of enactment of this Act.

H.R. 5116, §702, 103d Cong., 2d Sess., 140 Cong.Rec. 142 (daily edition October 4, 1994), H. 10752, 10763